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(<sup>1</sup>) Text with EEA relevance

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Acts whose titles are printed in light type are those relating to day-to-day management of agricultural matters, and are generally valid for a limited period.

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## I

(Legislative acts)

## REGULATIONS

**REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL****of 26 June 2013****on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012****(Text with EEA relevance)**

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 Central Bank <sup>(1)</sup>,

Having regard to the opinion of the European Economic and Social Committee <sup>(2)</sup>,

Acting in accordance with the ordinary legislative procedure,

Whereas:

(1) The G-20 Declaration of 2 April 2009 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. That declaration also called for introduction of a supplementary non-risk based measure to contain the build-up of leverage in the banking system, and the development of a framework for stronger liquidity buffers. In response to the mandate

given by the G-20, 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. Those measures were endorsed by the G-20 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 those new measures, and in December 2010, the Basel Committee on Banking Supervision (BCBS) published the final measures, that are referred to as the Basel III framework.

(2) The High Level Group on Financial Supervision in the EU chaired by Jacques de Larosière (the "de Larosière group") invited the Union to develop a more harmonised set of financial regulations. 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 internal market.

(3) As stated in the de Larosière group's report of 25 February 2009 (the "de Larosière report"), "a Member State should be able to adopt more stringent national regulatory measures considered to be domestically appropriate for safeguarding financial stability as long as the principles of the internal market and agreed minimum core standards are respected".

(4) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions <sup>(3)</sup> and Directive 2006/49/EC of the European Parliament and of

<sup>(1)</sup> OJ C 105, 11.4.2012, p. 1.

<sup>(2)</sup> OJ C 68, 6.3.2012, p. 39.

<sup>(3)</sup> OJ L 177, 30.6.2006, p. 1.

the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions<sup>(1)</sup> 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. For the sake of clarity and in order to ensure a coherent application of those provisions, they should be merged into new legislative acts that are applicable to both credit institutions and investment firms, namely this Regulation and Directive 2013/36/EU of the European Parliament and of the Council<sup>(2)</sup>. For greater accessibility, the provisions of the Annexes to Directives 2006/48/EC and 2006/49/EC should be integrated into the enacting terms of Directive 2013/36/EU and this Regulation.

- (5) Together, this Regulation and Directive 2013/36/EU should form the legal framework governing the access to the activity, the supervisory framework and the prudential rules for credit institutions and investment firms (referred to collectively as "institutions"). This Regulation should therefore be read together with that Directive
- (6) Directive 2013/36/EU, based on Article 53(1) of the Treaty on the Functioning of the European Union (TFEU), should, *inter alia*, contain the provisions concerning the access to the activity of institutions, 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 the competent authorities of the home and the host Member States in this regard and the provisions governing the initial capital and the supervisory review of institutions.
- (7) This Regulation should, *inter alia*, contain the prudential requirements for institutions that relate strictly to the functioning of banking and financial services markets and are meant to ensure the financial stability of the operators on those markets as well as a high level of protection of investors and depositors. This Regulation aims at contributing in a determined 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.
- (8) 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 the internal market.

- (9) For reasons of legal certainty and because of the need for a level playing field within the Union, a single set of regulations for all market participants is a key element for the functioning of the internal market. In order to avoid market distortions and regulatory arbitrage, prudential minimum requirements should therefore ensure maximum harmonisation. As a consequence, the transitional periods provided for in this Regulation are essential for the smooth implementation of this Regulation and to avoid uncertainty for the markets.
- (10) Having regard to work of the BCBS' Standards Implementation Group in monitoring and reviewing member countries' implementation of the Basel III framework, the Commission should provide update reports on an ongoing basis, and at least following the publication of each Progress Report by BCBS, on the implementation and domestic adoption of the Basel III framework in other major jurisdictions, including an assessment of the consistency of other countries' legislation or regulations with the international minimum standards, in order to identify differences that could raise level playing field concerns.
- (11) 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.
- (12) Shaping prudential requirements in the form of a regulation would ensure that those requirements will be directly applicable. This would ensure uniform conditions by preventing diverging national requirements as a result of the transposition of a directive. This Regulation would entail that all institutions follow the same rules in all the Union, which would also boost confidence in the stability of institutions, especially in times of stress. A regulation would also reduce regulatory complexity and firms' compliance costs, especially for institutions 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.

<sup>(1)</sup> OJ L 177, 30.6.2006, p. 201.

<sup>(2)</sup> See page 338 of this Official Journal.

- (13) In areas not covered by this Regulation, such as dynamic provisioning, provisions on national covered bonds schemes not related to the treatment of covered bonds under the rules established by this Regulation, acquisition and holding of participations in both the financial and non-financial sector for purposes not related to prudential requirements specified in this Regulation, competent authorities or Member States should be able to impose national rules, provided that they are not inconsistent with this Regulation.
- (14) The most important recommendations advocated in the de Larosière report and later implemented in the Union were the establishment of a single rulebook and a European framework for macroprudential supervision where both elements in combination were aimed at ensuring financial stability. The single rulebook ensures a robust and uniform regulatory framework facilitating the functioning of the internal market and prevents regulatory arbitrage opportunities. Within the internal market for financial services, macroprudential risks may however differ in a number of ways with a range of national specificities resulting in variances being observed for example with regard to the structure and size of the banking sector compared to the wider economy and the credit cycle.
- (15) A number of tools to prevent and mitigate macroprudential and systemic risks have been built into this Regulation and Directive 2013/36/EU ensuring flexibility while at the same time ensuring that the use of those 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 is transparent and consistent.
- (16) Beyond the systemic risk buffer tool included in Directive 2013/36/EU, where macroprudential or systemic risks concern a Member State, the competent or designated authorities of the relevant Member State should have the possibility to address those risks by certain specific national macroprudential measures, when this is considered more effective to tackle those risks. The European Systemic Risk Board ("ESRB") established by Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010<sup>(1)</sup> and the European Supervisory Authority (European Banking Authority) ("EBA") established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010<sup>(2)</sup> should have the opportunity to provide their opinions on whether the conditions for such national macroprudential measures are met and there should be a Union mechanism to prevent national measures from proceeding, where there is very strong evidence that the relevant conditions are not satisfied. Whilst this Regulation establishes uniform microprudential rules for institutions, Member States retain a leading role in macroprudential oversight because of their expertise and their existing responsibilities in relation to financial stability. In that specific case, since the decision to adopt any national macroprudential measures includes certain assessments in relation to risks which may ultimately affect the macroeconomic, fiscal and budgetary situation of the relevant Member State, it is necessary that the power to reject the proposed national macroprudential measures is conferred on the Council in accordance with Article 291 TFEU, acting on a proposal by the Commission.
- (17) Where the Commission has submitted to the Council a proposal to reject national macroprudential measures, the Council should examine that proposal without delay and decide whether or not to reject the national measures. A vote could be taken in accordance with the Rules of Procedure of the Council<sup>(3)</sup> at the request of a Member State or of the Commission. In accordance with Article 296 TFEU, the Council should state the reasons for its decision with respect to the conditions laid down in this Regulation for its intervention. Considering the importance of the macroprudential and systemic risk for the financial market of the Member State concerned and therefore the need for rapid reaction, it is important that the time limit for such a Council decision is set to one month. If the Council, after having examined the proposal by the Commission to reject the proposed national measures in depth, comes to the conclusion that the conditions laid down in this Regulation for the rejection of the national measures were not fulfilled, it should always provide its reasons in a clear and unambiguous manner.
- (18) Until the harmonisation of liquidity requirements in 2015 and the harmonisation of a leverage ratio in 2018, Member States should be able to apply such measures as they consider appropriate, including measures to mitigate macroprudential or systemic risk in a specific Member State.
- (19) It should be possible to apply systemic risk buffers or individual measures taken by Member States to address systemic risks concerning those Member States, to the banking sector in general or to one or more subsets of the sector, meaning subsets 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.

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

<sup>(2)</sup> OJ L 331, 15.12.2010, p. 12.

<sup>(3)</sup> Council Decision 2009/937/EU of 1 December 2009 adopting the Council's Rules of Procedure (OJ L 325, 11.12.2009, p. 35).

- (20) If two or more Member States' designated authorities identify the same changes in the intensity of systemic or macroprudential risk posing a risk to financial stability at the national level in each Member State which the designated authorities consider would better be addressed by means of national measures, the Member States may submit a joint notification to the Council, the Commission, the ESRB and EBA. When notifying the Council, the Commission, the ESRB and EBA Member States should submit relevant evidence, including a justification of the joint notification.
- (21) The Commission should furthermore be empowered to adopt a delegated act temporarily increasing the level of own funds requirements, requirements for large exposures and public disclosure requirements. 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 three months. The Commission should state the reasons for the use of such a procedure. The Commission should only be empowered to impose stricter prudential requirements for exposures which arise from market developments in the Union or outside the Union affecting all Member States.
- (22) A review of the macroprudential rules is justified in order for the Commission to assess, among other things, whether the macroprudential tools in this Regulation or Directive 2013/36/EU are effective, efficient and transparent, whether new instruments should be proposed, whether the coverage and the possible degrees of overlap of the macroprudential tools for targeting similar risks in this Regulation or Directive 2013/36/EU are appropriate and how internationally agreed standards for systemically important institutions interacts with this Regulation or Directive 2013/36/EU.
- (23) 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.
- (24) This Regulation does not prevent Member States from imposing, where appropriate, equivalent requirements on undertakings that do not fall within its scope.
- (25) 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 institutions. The range of such supervisory arrangements should, *inter alia*, be set out in Directive 2013/36/EU since the competent authorities should be able to exert their judgment as to which arrangements should be imposed.
- (26) 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 2013/36/EU that should be tailored to the specific risk profile of institutions.
- (27) Regulation (EU) No 1093/2010 aims at upgrading the quality and consistency of national supervision and strengthening oversight of cross-border groups.
- (28) Given the increase in the number of tasks conferred on EBA by this Regulation and by Directive 2013/36/EU, the European Parliament, the Council and the Commission should ensure that adequate human and financial resources are made available without delay.
- (29) 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 institutions 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 Directives. This Regulation should take into account the role and function of EBA and facilitate the exercise of EBA's powers set out in Regulation (EU) No 1093/2010.
- (30) After the observation period and the full implementation of a liquidity coverage requirement in accordance with this Regulation, the Commission should assess whether granting EBA a power of initiative to intervene with binding mediation in relation to the reaching of joint decisions by the competent authorities under Articles 20 and 21 of this Regulation would facilitate the practical formation and operation of single liquidity sub-groups as well as the determination of whether criteria for a specific intragroup treatment for cross-border institutions are met. Therefore, at that time, as part of one of the regular reports on the operation of EBA under Article 81 of Regulation (EU) No 1093/2010, the Commission should specifically examine the need to grant EBA such powers and include the results of this examination in its report, which should be accompanied by appropriate legislative proposals, where appropriate.



- (31) The de Larosière report stated that microprudential supervision cannot effectively safeguard financial stability without adequately taking account of developments at macro level, while macroprudential oversight is not meaningful unless it can somehow impact on supervision at the micro level. Close cooperation between EBA and the ESRB is essential to give full effectiveness to the functioning of the ESRB and follow up to its warnings and recommendations. In particular, EBA should be able to transmit to the ESRB all relevant information gathered by competent authorities in accordance with the reporting obligations set out in this Regulation.
- (32) Considering the devastating effects of the latest financial crisis the overall objectives of this Regulation are to encourage economically useful banking activities that serve the general interest and to discourage unsustainable financial speculation without real added value. This implies a comprehensive reform of the ways savings are channelled into productive investments. In order to safeguard a sustainable and diverse banking environment in the Union, competent authorities should be empowered to impose higher capital requirements for systemically important institutions that are able, due to their business activities, to pose a threat to the global economy.
- (33) Equivalent financial requirements for institutions 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 institutions.
- (34) Since institutions in the internal market are engaged in direct competition, monitoring requirements should be equivalent throughout the Union taking into account the different risk profiles of the institutions.
- (35) Whenever in the course of supervision it is necessary to determine the amount of the consolidated own funds of a group of institutions, the calculation should be effected in accordance with this Regulation.
- (36) 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 institutions.
- (37) In order to ensure adequate solvency of institutions within a group it is essential that the capital requirements apply on the basis of the consolidated situation of those institutions within 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 institutions within a group, unless this objective can be effectively achieved otherwise.
- (38) The minority interests arising from intermediate financial holding companies that are subject to the requirements of this Regulation on a sub-consolidated basis may also be eligible, within the relevant limits, as Common Equity Tier 1 capital 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.
- (39) The precise accounting technique to be used for the calculation of own funds, their adequacy for the risk to which an institution 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 institutions under national law.
- (40) 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.
- (41) 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 Directives 2006/48/EC and 2006/49/EC that this Regulation has taken over form an equivalent to the provisions of the Basel II framework. Consequently, by incorporating the supplementary elements of the Basel III framework this Regulation forms an equivalent to the provisions of the Basel II and III frameworks.

<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.

- (42) It is essential to take account of the diversity of institutions 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 institutions' own estimates of individual credit risk parameters represents a significant enhancement in the risk-sensitivity and prudential soundness of the credit risk rules. Institutions 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, institutions should enhance their credit risk measurement and management processes to make available methods for determining regulatory own funds requirements that reflect the nature, scale, and complexity of individual institutions' 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 interests of institutions 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. Notwithstanding this, the more risk-sensitive approaches require considerable expertise and resources as well as data of high quality and sufficient volume. Institutions should therefore comply with high standards before applying those approaches for regulatory own funds purposes. Given the ongoing work on ensuring appropriate backstops to internal models, the Commission should prepare a report on the possibility of extending the Basel I floor together with a legislative proposal, if appropriate.
- (43) 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.
- (44) Small and medium-sized enterprises (SMEs) are one of the pillars of the Union economy given their fundamental role in creating economic growth and providing employment. The recovery and future growth of the Union economy depends largely on the availability of capital and funding to SMEs established in the Union to carry out the necessary investments to adopt new technologies and equipment to increase their competitiveness. The limited amount of alternative sources of funding has made SMEs established in the Union even more sensitive to the impact of the banking crisis. It is therefore important to fill the existing funding gap for SMEs and ensure an appropriate flow of bank credit to SMEs in the current context. Capital charges for exposures to SMEs should be reduced through the application of a supporting factor equal to 0,7619 to allow credit institutions to increase lending to SMEs. To achieve this objective, credit institutions should effectively use the capital relief produced through the application of the supporting factor for the exclusive purpose of providing an adequate flow of credit to SMEs established in the Union. Competent authorities should monitor periodically the total amount of exposures to SMEs of credit institutions and the total amount of capital deduction.
- (45) 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 capable of being fully and permanently written down or converted fully into Common Equity Tier 1 capital at the point of non-viability of the institution. Necessary legislation to ensure that own funds instruments are subject to the additional loss absorption mechanism should be incorporated into Union law as part of the requirements in relation to the recovery and resolution of institutions. If by 31 December 2015, Union law governing the requirement that capital instruments should be capable of being fully and permanently written down to zero or converted into Common Equity Tier 1 instruments in the event that an institution is no longer considered viable has not been adopted, the Commission should review and report on whether such a provision should be included in this Regulation and, in light of that review, submit appropriate legislative proposals.
- (46) 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 institutions. Respect for 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. Member States should ensure that the requirements laid down in this Regulation apply in a manner proportionate to the nature, scale and complexity of the risks associated with an institution's business model and activities. The Commission should ensure that delegated and implementing acts, regulatory technical standards and implementing technical standards are consistent with the principle of proportionality, so as to guarantee that this Regulation is applied in a proportionate manner. EBA should therefore ensure that all regulatory and implementing technical standards are drafted in such a way that they are consistent with and uphold the principle of proportionality.
- (47) Competent authorities should pay appropriate attention to cases where they suspect that information is regarded as proprietary or confidential in order to avoid disclosure of such information. Although an institution may opt not to disclose information as the information is regarded as proprietary or confidential, the fact that information is being regarded as proprietary or confidential should not discharge liability arising from non-disclosure of that information when such non-disclosure is found to have material effect.



- (48) The 'evolutionary' nature of this Regulation enables institutions to choose amongst three approaches to credit risk of varying complexity. In order to allow especially small institutions to opt for the more risk-sensitive IRB Approach, the relevant provisions should be read so 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. institutions operating according to the provisions of the Standardised Approach should not for that reason alone be supervised on a stricter basis.
- (49) 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.
- (50) In order to ensure that the risks and risk reductions arising from institutions' securitisation activities and investments are appropriately reflected in the capital requirements of institutions it is necessary to include rules providing for a risk-sensitive and prudentially sound treatment of such activities and investments. To this end, a clear and encompassing definition of securitisation is needed that captures any transaction or scheme whereby the credit risk associated with an exposure or pool of exposures is tranching. An exposure that creates a direct payment obligation for a transaction or scheme used to finance or operate physical assets should not be considered an exposure to a securitisation, even if the transaction or scheme has payment obligations of different seniority.
- (51) Alongside surveillance aimed at ensuring financial stability, there is a need for mechanisms designed to enhance and develop an effective surveillance and prevention of potential bubbles in order to ensure optimum allocation of capital in the light of the macro-economic challenges and objectives, in particular with respect to long term investment in the real economy.
- (52) Operational risk is a significant risk faced by institutions requiring coverage by own funds. It is essential to take account of the diversity of institutions 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 institutions 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.
- (53) The monitoring and control of an 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 an institution.
- (54) 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 institution itself, its financial group or its connected parties.
- (55) 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.
- (56) Since a loss arising from an exposure to an institution 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.

- (57) 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.
- (58) This Regulation also provides that there be no multiple applications of the retention requirement. For any given securitisation it suffices that only 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. The Commission should also review whether avoidance of multiple applications of the retention requirement could be conducive to practices circumventing the retention requirement and whether the rules on securitisations are enforced effectively by the competent authorities.
- (59) 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.
- (60) 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 the case of large exposures and in cases not simply related to intragroup administration or usual intragroup transactions. Competent authorities should pay particular attention to such intragroup 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.
- (61) 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 (ECB), should report on these aspects to the European Parliament and to the Council.
- (62) The capital requirements for commodity dealers, including those dealers currently exempt from the requirements of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments <sup>(1)</sup>, should be reviewed.
- (63) 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.
- (64) Institutions investing in re-securitisations should exercise due diligence also with regard to the underlying securitisations and the non-securitisation exposures ultimately underlying the former. Institutions 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

<sup>(1)</sup> OJ L 145, 30.4.2004, p. 1.

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 institution, 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.

- (65) 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 institutions. 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.
- (66) Institutions 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.
- (67) 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.
- (68) 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. Institutions should therefore be required to disclose additional information not explicitly listed in this Regulation where such disclosure is necessary to meet that aim. At the same time, competent authorities should pay appropriate attention to cases where they suspect that information is regarded as proprietary or confidential by an institution in order to avoid disclosure of such information.
- (69) 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 that credit protection into account.

- (70) 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. Institutions 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 recognition of institutions' modelling of securitisation risks to calculate capital requirements in the trading book should be limited and a standardised capital charge for securitisation positions in the trading book should be required by default.
- (71) 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.
- (72) In light of the nature and magnitude of unexpected losses experienced by institutions during the financial and economic crisis, it is necessary to improve further the quality and harmonisation of own funds that institutions 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 institutions whose shares are admitted to trading on a regulated market should

meet their capital requirements regarding the core elements of capital with such 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 institutions within the Union are operating under, the strict set of criteria for the core capital instruments should ensure that core capital instruments for institutions whose shares are not admitted to trading on a regulated market are of the highest quality. This should not prevent institutions from paying, on shares that have differentiated or no voting rights, distributions that are a multiple of those paid on shares which have relatively higher levels of voting rights, provided that, irrespective of the level of voting rights, the strict criteria for Common Equity Tier 1 instruments are met, including those relating to the flexibility of payments, and provided that where a distribution is paid it is to be paid on all shares issued by the institution concerned.

(73) Trade finance exposures are diverse in nature but share characteristics such as being small in value and short in duration and having an identifiable source of repayment. They are underpinned by movements of goods and services that support the real economy and in most cases help small companies in their day-to-day needs, thereby creating economic growth and job opportunities. Inflows and outflows are usually matched and liquidity risk is therefore limited.

(74) It is appropriate that EBA keeps an up-to-date list of all of the forms of capital instruments in each Member State that qualify as Common Equity Tier 1 instruments. EBA should remove from that list non-State aid instruments issued after the date of entry into force of this Regulation not meeting the criteria specified in this Regulation and should publicly announce such removal. Where instruments removed by EBA from the list continue to be recognised after EBA's announcement, EBA should fully exercise its powers, in particular those conferred by Article 17 of Regulation (EU) No 1093/2010 concerning breaches of Union law. It is recalled that a three-step mechanism applies for a proportionate response to instances of incorrect or insufficient application of Union law, whereby, as a first step, EBA is empowered to investigate alleged incorrect or insufficient application of Union law obligations by national authorities in their supervisory practice, concluded by a recommendation. Second, where the competent national authority does not follow the recommendation, the Commission is empowered to issue a formal opinion taking into account the EBA's recommendation, requiring the competent authority to take the actions necessary to ensure compliance with Union law. Third, to overcome exceptional situations of persistent inaction by the competent authority concerned, the EBA is empowered, as a last resort, to adopt decisions addressed to individual financial institutions. Moreover, it is recalled that, under Article 258 TFEU, where the Commission considers that a Member State has failed to fulfil an obligation under the Treaties, it has the power to bring the matter before the Court of Justice of the European Union.

(75) 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 those cases such capital instruments should only be computed towards the institution's Additional Tier 1 capital or Tier 2 capital once they have successfully completed these approval processes.

(76) 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 institutions.

(77) It is further necessary for competent authorities to have knowledge of the level, at least in aggregate terms, of repurchase agreements, securities lending and all forms of encumbrance of assets. Such information should be reported to the competent authorities. For the purposes of strengthening market discipline, there should be more detailed requirements for disclosure of repurchase agreements and secured funding.

(78) 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 the date of application of this Regulation will be grandfathered for the extent of the transition period. Reliance on State aid should be reduced as much as possible in the future. However, to the extent that State aid proves necessary in certain situations, this Regulation should provide for a framework to deal with such situations. In particular, this Regulation should specify what should be the treatment for own funds instruments issued within the context of a recapitalisation measure pursuant to State aid rules. The possibility for institutions to benefit from such treatment should be subject to strict conditions. Furthermore, to the extent that such treatment allows for deviations from the new criteria on the quality of own funds instruments those deviations should be limited to the largest extent possible. The treatment for existing capital instruments issued within the context of a recapitalisation measure pursuant to State aid- rules, should clearly distinguish between those capital instruments that comply with the requirements of this Regulation and those that do not. Appropriate transitional provisions for the latter case should therefore be laid down in this Regulation.



- (79) 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 the date of application of this Regulation to 2019.
- (80) For groups which include significant banking or investment business and insurance business, Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate<sup>(1)</sup>, 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 Regulation strengthens the way those 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, which is expected in 2015.
- (81) The financial crisis highlighted that institutions greatly underestimated the level of counterparty credit risk associated with over-the-counter (OTC) derivatives. This prompted the G-20, in September 2009, to call for more OTC derivatives to be cleared through a central counterparty (CCP). Furthermore, they asked for those OTC derivatives that could not be cleared centrally to be subject to higher own funds requirements in order to properly reflect the higher risks associated with them.
- (82) Following the G-20 call, the BCBS, as part of the Basel III framework, materially changed the counterparty credit risk regime. The Basel III framework is expected to significantly increase the own fund requirements associated with institutions' OTC derivatives and securities financing transactions and to create important incentives for institutions to use CCPs. The Basel III framework 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.
- (83) 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. Institutions 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.
- (84) Trade exposures to CCPs usually benefit from the multi-lateral 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 institutions 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.
- (85) A CCP's default fund is a mechanism that allows the sharing (mutualisation) of losses among the CCP's clearing members. It is used where 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 that associated with trade exposures. Therefore, this type of exposures should be subject to a higher own funds requirement.
- (86) 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.
- (87) 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 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories<sup>(2)</sup>.

<sup>(1)</sup> OJ L 35, 11.2.2003, p. 1.

<sup>(2)</sup> OJ L 201, 27.7.2012, p. 1.



- (88) The Commission should review the relevant exemptions for large exposures by 31 December 2015. Pending the outcome of that 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 of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management <sup>(1)</sup> and taking into account international and Union developments on those issues, the Commission should review whether those exemptions 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.
- (89) In order to ensure that exemptions of 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 that review, the competent authorities should consult EBA on whether or not it is appropriate to continue making use of the possibility to exempt certain exposures.
- (90) The years preceding the financial crisis were characterised by an excessive build up in institutions' exposures in relation to their own funds (leverage). During the financial crisis, losses and the shortage of funding forced institutions to reduce significantly their leverage over a short period of time. This amplified downward pressures on asset prices, causing further losses for institutions 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.
- (91) Risk-based own funds requirements are essential to ensure sufficient own funds to cover unexpected losses. However, the crisis has shown that those requirements alone are not sufficient to prevent institutions from taking on excessive and unsustainable leverage risk.
- (92) In September 2009, the G-20 leaders committed to developing internationally-agreed rules to discourage an excessive leverage. To that end, they supported the introduction of a leverage ratio as a supplementary measure to the Basel II framework.
- (93) In December 2010, the BCBS published guidelines defining the methodology for calculating the leverage ratio. Those rules provide for 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 provide for disclosure of the leverage ratio and its components starting from 1 January 2015.
- (94) 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.
- (95) 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. EBA, on the basis of data received and the findings of the supervisory review during an observation period, should in cooperation with competent authorities develop a classification of business models and risks. Based on appropriate analysis, and also taking into account historical data or stress scenarios, there should be an assessment of the appropriate levels of the leverage ratio that safeguard the resilience of the respective business models and whether the levels of the leverage ratio should be set as thresholds or ranges. After the observation period and the calibration of the respective levels of the leverage ratio, and on the basis of the assessment, EBA can publish an appropriate statistical review, including averages and standard deviations, of the leverage ratio. After adoption of the leverage ratio requirements, EBA should publish an appropriate statistical review, including averages and standard deviations, of the leverage ratio in relation to the identified categories of institutions.
- (96) Institutions 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). Such monitoring should be included in the supervisory review process. In particular, after the entry into force of the leverage ratio requirements, competent authorities should monitor the developments in the business model and corresponding risk profile in order to ensure up to date and proper classification of institutions.

<sup>(1)</sup> OJ L 302, 17.11.2009, p. 97.

- (97) 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, institutions 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 institution. That information should be made available to all stakeholders. Those particular requirements should be without prejudice to more general disclosure requirements concerning remuneration policies applicable horizontally across sectors. Moreover, Member States should be allowed to require institutions to make available more detailed information on remuneration.
- (98) The recognition of a credit rating agency as an external credit assessment institution (ECAI) should not increase the foreclosure of a market already dominated by three main undertakings. EBA and ESCB central banks, without making the process easier or less demanding, should provide for the recognition of more credit rating agencies as ECAIs as a way to open the market to other undertakings.
- (99) Directive 95/46/EC 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 (EC) 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 Community 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.
- (100) Institutions should hold a diversified buffer of liquid assets that they can use to cover liquidity needs in a short term liquidity stress. As it is not possible to know ex ante with certainty which specific assets within each asset class might be subject to shocks ex post, it is appropriate to promote a diversified and high-quality liquidity buffer consisting of different asset categories. A concentration of assets and overreliance on market liquidity creates systemic risk to the financial sector and should be avoided. A broad set of quality assets should therefore be taken into consideration during an initial observation period which will be used for the development of a definition of a liquidity coverage requirement. When making a uniform definition of liquid assets at least government bonds, and covered bonds traded on transparent markets with an ongoing turnover would be expected to be considered assets of extremely high liquidity and credit quality. It would also be appropriate that assets corresponding to Article 416(1)(a) to (c) should be included in the buffer without limitations. When institutions use the liquidity 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.
- (101) 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 and investment models and funding environments of institutions across the Union. To this end, the liquidity coverage requirement should be subject to an observation period. Based on the observations and supported by reports from EBA, the Commission should be empowered to adopt a delegated act to introduce in a timely manner a detailed and harmonised liquidity coverage requirement for the Union. In order to ensure global harmonisation in the area of regulation of liquidity any delegated act to introduce the liquidity coverage requirement should be comparable to the liquidity coverage ratio set out in the final international framework for liquidity risk measurement, standards and monitoring of the BCBS taking into account Union and national specificities.
- (102) To that end, during the observation period, EBA should review and assess, inter alia the appropriateness of a threshold of 60 % on level 1 liquid assets, a cap of 75 % of inflows to outflows and the phase-in of the liquidity coverage requirement from 60 % from 1 January 2015 increasing on a graduated basis to 100 %. When assessing and reporting on the uniform definitions of the stock of liquid assets, EBA should have regard to the BCBS definition of high quality liquid assets (HQLA) for the basis of its analysis, taking Union and national specificities into account. While EBA should identify those currencies where the needs of institutions established in the Union for liquid assets exceeds the availability of those liquid assets in that currency, EBA should also annually examine whether derogations, including those identified in this Regulation, should be applied. In addition, EBA should assess annually whether in relation to any such derogation as well as derogations already identified in this Regulation, any additional conditions should be attached to their use by institutions established in the Union or whether existing conditions should be revised. EBA should submit the results of its analysis in an annual report to the Commission.

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

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

- (103) With a view to increasing efficiency and reducing the administrative burden, EBA should set up a coherent reporting framework on the basis of a harmonised set of standards for liquidity requirements that should be applied across the Union. To this end, EBA should develop uniform reporting formats and IT solutions that take into account the provisions of this Regulation and Directive 2013/36/EU. Until the date of application of the full liquidity requirements, institutions should continue to meet their national reporting requirements.
- (104) EBA, in cooperation with the ESRB, should issue guidance on the principles for use of liquid stock in a stress situation.
- (105) It should not be taken for granted that institutions will receive liquidity support from other institutions belonging to the same group when they experience difficulties in meeting 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 liquidity requirement for individual institutions and subject those institutions to a consolidated requirement, in order to allow them to manage their liquidity centrally at group or sub-group level.
- (106) 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 liquidity requirement 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 intragroup 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 as part of the delegated act which it adopts pursuant to this Regulation to specify the liquidity coverage requirement, be empowered to adopt delegated acts to lay down those specific intragroup treatments, the methodology and the objective criteria to which they are linked as well as joint decision modalities for the assessment of those criteria.
- (107) Bonds issued by the National Asset Management Agency (NAMA) in Ireland are of particular importance to the Irish banking recovery and their issue has been granted prior approval by the Member States, and approved as a State aid by the Commission as a support measure introduced to remove impaired assets from the balance sheets of certain credit institutions. The issuance of such bonds, a transitional measure supported by the Commission and the ECB, is an integral part in the restructuring of the Irish banking system. Such bonds are guaranteed by the Irish government and are eligible collateral with monetary authorities. The Commission should address specific grandfathering mechanisms of transferable assets issued or guaranteed by entities with Union State aid approval, as part of the delegated act which it adopts pursuant to this Regulation to specify the liquidity coverage requirement. In that regard the Commission should take into account the fact that institutions calculating the liquidity coverage requirements in accordance with this Regulation should be permitted to include NAMA senior bonds as assets of extremely high liquidity and credit quality until December 2019.
- (108) Similarly, the bonds issued by the Spanish Asset Management Company are of particular importance to the Spanish banking recovery and are a transitional measure supported by the Commission and the ECB, as an integral part in the restructuring of the Spanish banking system. Since their issuance is provided for in the Memorandum of Understanding on Financial Sector Policy Conditionality signed by the Commission and the Spanish Authorities on 23 July 2012, and the transfer of assets requires approval by the Commission as a State aid measure introduced to remove impaired assets from the balance sheets of certain credit institutions, and to the extent they are guaranteed by the Spanish government and are eligible collateral with monetary authorities. The Commission should address specific grandfathering mechanisms of transferable assets issued or guaranteed by entities with Union State aid approval as part of the delegated act which it adopts pursuant to this Regulation to specify the liquidity coverage requirement. In that regard the Commission should take into account the fact that institutions calculating the liquidity coverage requirements in accordance with this Regulation should be permitted to include Spanish Asset Management Company senior bonds as assets of extremely high liquidity and credit quality until at least December 2023.
- (109) On the basis of the reports which EBA is required to submit and when preparing the proposal for a delegated act on liquidity requirements, the Commission should also consider if senior bonds issued by legal entities similar to NAMA in Ireland or the Spanish Asset Management Company, established for the same purpose and of particular importance for bank recovery in any other Member State, should be granted such treatment, to the extent they are guaranteed by the central government of the relevant Member State and are eligible collateral with monetary authorities.
- (110) In developing draft regulatory technical standards to determine methods for the measurement of additional outflow, EBA should consider a historical look back standardised approach as a method of such measurement.

- (111) Pending the introduction of the net stable funding ratio (NSFR) as a binding minimum standard, institutions should observe a general funding obligation. The general funding obligation should not be a ratio requirement. If, pending the introduction of the NSFR, a stable funding ratio is introduced as a minimum standard by way of a national provision, institutions should comply with this minimum standard accordingly.
- (112) Apart from short-term liquidity needs, institutions should also adopt funding structures that are stable over 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 that 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 the European Parliament and the Council together with any appropriate proposals in order to introduce such a requirement by 2018.
- (113) Weaknesses in corporate governance in a number of institutions have contributed to excessive and imprudent risk-taking in the banking sector which led to the failure of individual institutions and systemic problems.
- (114) In order to facilitate the monitoring of institutions' corporate governance practices and improve market discipline, institutions 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.
- (115) In order to take account of the diversity of business models of institutions in the internal market certain long-term structural requirements such as the NSFR and the leverage ratio should be examined closely with a view of promoting a variety of sound banking structures which have been and should continue to of service to the Union's economy.
- (116) For the continuous provision of financial services to households and firms a stable funding structure is necessary. Long-term funding flows in bank-based financial systems in many Member States may generally possess different characteristics than those found in other international markets. In addition, specific funding structures may have developed in Member States to provide stable financing for long-term investment, including decentralised banking structures to channel liquidity or specialised mortgage securities which trade on highly liquid markets or are a welcome investment for long-term investors. Those structural factors should be carefully considered. It is essential to that purpose that, once international standards are finalised, EBA and the ESRB, based on reporting required by this Regulation, evaluate how a stable funding requirement should be designed fully taking into account the diversity of funding structures in the banking market in the Union.
- (117) 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.
- (118) 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.
- (119) 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 should under certain circumstances qualify as Common Equity Tier 1.
- (120) 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.



- (121) In order to take account of market developments and experience in the application of this Regulation, the Commission should be required to submit reports to the European Parliament and to the Council, together with legislative proposals, where appropriate, 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.
- (122) The primary purpose of the legal framework for credit institutions should be to ensure the operation of vital services to the real economy while limiting the risk of moral hazard. The structural separation of retail and investment banking activities within a banking group could be one of the key tools to support this objective. No provision in the current regulatory framework should therefore prevent the introduction of measures to effect such a separation. The Commission should be required to analyse the issue of structural separation in the Union and submit a report, together with legislative proposals, if appropriate, to the European Parliament and the Council.
- (123) Similarly, with a view to protecting depositors and preserving financial stability, Member States should also be permitted to adopt structural measures that require credit institutions authorised in that Member State to reduce their exposures to different legal entities depending on their activities, irrespective of where those activities are located. However, because such measures could have a negative impact by fragmenting the internal market, they should only be approved subject to strict conditions pending the entry into force of a future legal act explicitly harmonising such measures.
- (124) In order to specify the requirements set out in this Regulation, the power to adopt acts in accordance with Article 290 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 this Regulation on own funds to reflect developments in accounting standards or Union law, or with regard to the convergence of supervisory practices, to expand the lists of exposure classes for the purposes of the Standardised Approach or the IRB Approach to take account of developments on financial markets, to adjust certain amounts relevant to those exposure classes to take into account the effects of inflation; to adjust the list and classification of off-balance sheet items and to adjust specific provisions and technical criteria on the treatment of counterparty credit risk, the Standardised Approach and the IRB Approach, credit risk mitigation, securitisation, operational risk, market risk, liquidity, leverage and disclosure in order to take account of developments on financial markets or in accounting standards or Union law, or with regard to the convergence of supervisory practices and risk measurement and to take account of the outcome of the review of various matters relating to the scope of Directive 2004/39/EC.
- (125) The power to adopt acts in accordance with Article 290 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. 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 to the Council.
- (126) In accordance with Declaration No 39 on Article 290 TFEU, the Commission should continue to consult experts appointed by the Member States in the preparation of draft delegated acts in the financial services area, in accordance with its established practice.
- (127) 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. EBA should ensure efficient administrative and reporting processes when drafting technical standards. The reporting formats should be proportionate to the nature, scale and complexity of the activities of the institutions.

- (128) The Commission should adopt draft regulatory technical standards developed by EBA in the areas of mutuals, cooperative societies, savings institutions or similar institutions, certain own funds instruments, prudential adjustments, deductions from own funds, additional own funds instruments, minority interests, services ancillary to banking, the treatment of credit risk adjustment, probability of default, loss given default, 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. The Commission and EBA should ensure that those standards and requirements can be applied by all institutions concerned in a manner that is proportionate to the nature, scale and complexity of those institutions and their activities.
- (129) The implementation of some delegated acts provided for in this Regulation, such as the delegated act concerning the liquidity coverage requirement, may potentially have a substantial impact on supervised institutions and the real economy. The Commission should ensure that the European Parliament and the Council are always well informed about relevant developments at international level and current thinking within the Commission well before the publication of delegated acts.
- (130) The Commission should also be empowered to adopt implementing technical standards developed by EBA 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 by means of implementing acts pursuant to Article 291 TFEU and in accordance with Article 15 of Regulation (EU) No 1093/2010.
- (131) Given the detail and number of regulatory technical standards that are to be adopted pursuant to this Regulation, where the Commission adopts a regulatory

technical standard which is the same as the draft regulatory technical standard submitted by EBA, the period within which the European Parliament or the Council may object to a regulatory technical standard, should, where appropriate, be further extended by one month. Moreover, the Commission should aim to adopt the regulatory technical standards in good time to permit the European Parliament and the Council to exercise full scrutiny, taking account of the volume and complexity of regulatory technical standards and the details of the European Parliament's and the Council's rules of procedure, calendar of work and composition.

- (132) In order to ensure a high degree of transparency, EBA should launch consultations relating to the draft technical standards referred to in this Regulation. EBA and the Commission should start preparing their reports on liquidity requirements and leverage, as provided for in this Regulation, as soon as possible.
- (133) 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 of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by the Member States of the Commission's exercise of implementing powers<sup>(1)</sup>.
- (134) In accordance with Article 345 TFEU, which provides that the Treaties are in no way to prejudice the rules in Member States governing the system of property ownership, this Regulation neither favours nor discriminates against types of ownership which are within its scope.
- (135) The European Data Protection Supervisor has been consulted in accordance with Article 28(2) of Regulation (EC) No 45/2001 and has adopted an opinion<sup>(2)</sup>.
- (136) Regulation (EU) No 648/2012 should be amended accordingly,

<sup>(1)</sup> OJ L 55, 28.2.2011, p. 13.

<sup>(2)</sup> OJ C 175, 19.6.2012, p. 1.

HAVE ADOPTED THIS REGULATION:

*Article 4*

### **Definitions**

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

- (1) 'credit institution' means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account;
- (2) 'investment firm' means a person as defined in point (1) of Article 4(1) of Directive 2004/39/EC, which is subject to the requirements imposed by that Directive, excluding the following:
  - (a) credit institutions;
  - (b) local firms;
  - (c) firms which are not authorised to provide the ancillary service referred to in point (1) of Section B of Annex I to Directive 2004/39/EC, which provide only one or more of the investment services and activities listed in points 1, 2, 4 and 5 of Section A of Annex I to that Directive, and which are not permitted to hold money or securities belonging to their clients and which for that reason may not at any time place themselves in debt with those clients;
- (3) "institution" means a credit institution or an investment firm;.
- (4) '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;
- (5) 'insurance undertaking' means insurance undertaking as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) <sup>(1)</sup>;
- (6) 'reinsurance undertaking' means reinsurance undertaking as defined in point (4) of Article 13 of Directive 2009/138/EC;

## **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 institutions supervised under Directive 2013/36/EU shall comply with 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 delegated act referred to in Article 460 has entered into force, liquidity requirements relating to entirely quantifiable, uniform and standardised elements of liquidity risk;
- (d) reporting requirements related to points (a), (b) and (c) and to leverage;
- (e) public disclosure requirements.

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 2013/36/EU.

##### *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 2013/36/EU.

##### *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.

<sup>(1)</sup> OJ L 335, 17.12.2009, p. 1.

- (7) 'collective investment undertaking' or 'CIU' means a UCITS as defined in Article 1(2) 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>, including, unless otherwise provided, third-country entities which carry out similar activities, which are subject to supervision pursuant to Union law or to the law of a third country which applies supervisory and regulatory requirements at least equivalent to those applied in the Union, an AIF as defined in Article 4(1)(a) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers <sup>(2)</sup>, or a non-EU AIF as defined in Article 4(1)(aa) of that Directive;
- (8) 'public sector entity' means a non-commercial administrative body responsible to central governments, regional governments or local authorities, or to authorities that exercise the same responsibilities as regional governments and local authorities, or a non-commercial undertaking that is owned by or set up and sponsored by central governments, regional governments or local authorities, and that has explicit guarantee arrangements, and may include self-administered bodies governed by law that are under public supervision;
- (9) 'management body' means management body as defined in point (7) of Article 3(1) of Directive 2013/36/EU;
- (10) 'senior management' means senior management as defined in point (9) of Article 3(1) of Directive 2013/36/EU;
- (11) "systemic risk" means systemic risk as defined in point (10) of Article 3(1) of Directive 2013/36/EU;
- (12) "model risk" means model risk as defined in point (11) of Article 3(1) of Directive 2013/36/EU;
- (13) 'originator' means an entity which:
- (a) 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; or
  - (b) purchases a third party's exposures for its own account and then securitises them;
- (14) '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;
- (15) 'parent undertaking' means:
- (a) a parent undertaking within the meaning of Articles 1 and 2 of Directive 83/349/EEC;
  - (b) for the purposes of Section II of Chapters 3 and 4 of Title VII and Title VIII of Directive 2013/36/EU and Part Five 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;
- (16) 'subsidiary' means:
- (a) a subsidiary undertaking within the meaning of Articles 1 and 2 of Directive 83/349/EEC;
  - (b) a subsidiary undertaking 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.
- Subsidiaries of subsidiaries shall also be considered to be subsidiaries of the undertaking that is their original parent undertaking;
- (17) '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;
- (18) 'ancillary services undertaking' means an undertaking the principal activity of which consists of owning or managing property, managing data-processing services, or a similar activity which is ancillary to the principal activity of one or more institutions;
- (19) 'asset management company' means an asset management company as defined in point (5) of Article 2 of Directive 2002/87/EC and an AIFM as defined in Article 4(1)(b) of Directive 2011/61/EU, including, unless otherwise provided, third country entities, that carry out similar activities, that are subject to the laws of a third country which applies supervisory and regulatory requirements at least equivalent to those applied in the Union;

<sup>(1)</sup> OJ L 302, 17.11.2009, p. 32.

<sup>(2)</sup> OJ L 174, 1.7.2011, p. 1.

- (20) 'financial holding company' means a financial institution, the subsidiaries of which are 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;
- (21) 'mixed financial holding company' means mixed financial holding company as defined in point (15) of Article 2 of Directive 2002/87/EC;
- (22) '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;
- (23) 'third-country insurance undertaking' means third-country insurance undertaking as defined in point (3) of Article 13 of Directive 2009/138/EC;
- (24) 'third-country reinsurance undertaking' means third-country reinsurance undertaking as defined in point (6) of Article 13 of Directive 2009/138/EC;
- (25) 'recognised third-country investment firm' means a firm meeting all of the following conditions:
- (a) if it were established within the Union, it would be covered by the definition of an investment firm;
  - (b) it is authorised in a third country;
  - (c) it is subject to and complies with prudential rules considered by the competent authorities as at least as stringent as those laid down in this Regulation or in Directive 2013/36/EU;
- (26) '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 point 15 of Annex I to Directive 2013/36/EU, including a financial holding company, a mixed financial holding company, a payment institution within the meaning of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market <sup>(1)</sup>, and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined in point (g) of Article 212(1) of Directive 2009/138/E;
- (27) 'financial sector entity' means any of the following:
- (a) an institution;
  - (b) a financial institution;
  - (c) an ancillary services undertaking included in the consolidated financial situation of an institution;
  - (d) an insurance undertaking;
  - (e) a third-country insurance undertaking;
  - (f) a reinsurance undertaking;
  - (g) a third-country reinsurance undertaking;
  - (h) an insurance holding company;
  - (i) a mixed-activity holding company
  - (j) a mixed-activity insurance holding company as defined in point (g) of Article 212(1) of Directive 2009/138/EC;
  - (k) an undertaking excluded from the scope of Directive 2009/138/EC in accordance with Article 4 of that Directive;
  - (l) a third-country undertaking with a main business comparable to any of the entities referred to in points (a) to (k);
- (28) '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 or financial 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;
- (29) '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;
- (30) '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;

<sup>(1)</sup> OJ L 319, 5.12.2007, p. 1.

- (31) '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;
- (32) 'parent mixed financial holding company in a Member State' means a mixed 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 that same Member State;
- (33) '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;
- (34) 'central counterparty' or 'CCP' means a CCP as defined in point (1) of Article 2 of Regulation (EU) No 648/2012;
- (35) 'participation' means participation within the meaning of the first sentence of Article 17 of Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies<sup>(1)</sup>, or the ownership, direct or indirect, of 20 % or more of the voting rights or capital of an undertaking;
- (36) '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;
- (37) 'control' means the relationship between a parent undertaking and a subsidiary, as defined in Article 1 of Directive 83/349/EEC, or the accounting standards to which an institution is subject under Regulation (EC) No 1606/2002, or a similar relationship between any natural or legal person and an undertaking;
- (38) 'close links' means a situation in which two or more natural or legal persons are linked in any of the following ways:
- (a) participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of an undertaking;
- (b) control;
- (c) a permanent link of both or all of them to the same third person by a control relationship;
- (39) '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;
- (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.
- Notwithstanding points (a) and (b), 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 it in accordance with point (a), or interconnected with it in accordance with point (b), may be considered as not constituting 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 it in accordance with point (a), or directly interconnected with it in accordance with 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 in accordance with point (b), including the central government. The same applies in cases of regional governments or local authorities to which Article 115(2) applies
- (40) 'competent authority' means a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned;
- (41) 'consolidating supervisor' means a competent authority responsible for the exercise of supervision on a consolidated basis of EU parent institutions and of institutions controlled by EU parent financial holding companies or EU parent mixed financial holding companies;

<sup>(1)</sup> OJ L 222, 14.8.1978, p. 11.



- (42) 'authorisation' means an instrument issued in any form by the authorities by which the right to carry out the business is granted;
- (43) 'home Member State' means the Member State in which an institution has been granted authorisation;
- (44) 'host Member State' means the Member State in which an institution has a branch or in which it provides services;
- (45) 'ESCB central banks' means the national central banks that are members of the European System of Central Banks (ESCB), and the European Central Bank (ECB);
- (46) 'central banks' means the ESCB central banks and the central banks of third countries;
- (47) 'consolidated situation' means the situation that results from applying the requirements of this Regulation in accordance with Part One, Title II, Chapter 2 to an institution as if that institution formed, together with one or more other entities, a single institution;
- (48) 'consolidated basis' means on the basis of the consolidated situation;
- (49) 'sub-consolidated basis' means on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company, excluding a sub-group of entities, or on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company that is not the ultimate parent institution, financial holding company or mixed financial holding company;
- (50) 'financial instrument' 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) an instrument specified in Section C of Annex I to Directive 2004/39/EC;
  - (c) a derivative financial instrument;
  - (d) a primary financial instrument;
  - (e) a cash instrument.
- The instruments referred to in points (a), (b) and (c) are only financial instruments if their value is derived from the price of an underlying financial instrument or another underlying item, a rate, or an index;
- (51) 'initial capital' means the amount and types of own funds specified in Article 12 of Directive 2013/36/EU for credit institutions and in Title IV of that Directive for investment firms;
- (52) '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;
- (53) 'dilution risk' means the risk that an amount receivable is reduced through cash or non-cash credits to the obligor;
- (54) 'probability of default' or 'PD' means the probability of default of a counterparty over a one year period;
- (55) 'loss given default' or 'LGD' means the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default;
- (56) 'conversion factor' means the ratio of the currently undrawn amount of a commitment that could be drawn and that would therefore be outstanding at default to the currently undrawn amount of the commitment, the extent of the commitment being determined by the advised limit, unless the unadvised limit is higher;
- (57) '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;
- (58) '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;

- (59) '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 the occurrence of other specified credit events;
- (60) 'cash assimilated instrument' means a certificate of deposit, a bond, including a covered bond, or any other non-subordinated instrument, which has been issued by an institution, for which the institution has already received full payment and which shall be unconditionally reimbursed by the institution at its nominal value;
- (61) 'securitisation' means a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranching, 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;
- (62) 'securitisation position' means an exposure to a securitisation;
- (63) 're-securitisation' means securitisation where the risk associated with an underlying pool of exposures is tranching and at least one of the underlying exposures is a securitisation position;
- (64) 're-securitisation position' means an exposure to a re-securitisation;
- (65) '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;
- (66) 'securitisation special purpose entity' or 'SSPE' means a corporation trust or other entity, other than an institution, organised for carrying out 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 in which the holders of the beneficial interests have the right to pledge or exchange those interests without restriction;
- (67) 'tranche' means a contractually established segment of the credit risk associated with an exposure or a 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;
- (68) '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;
- (69) 'marking to model' means any valuation which has to be benchmarked, extrapolated or otherwise calculated from one or more market inputs;
- (70) 'independent price verification' means a process by which market prices or marking to model inputs are regularly verified for accuracy and independence;
- (71) 'eligible capital' means the sum of the following:
- (a) Tier 1 capital as referred to in Article 25;
  - (b) Tier 2 capital as referred to in Article 71 that is equal to or less than one third of Tier 1 capital;
- (72) 'recognised exchange' means an exchange which meets all of the following conditions:
- (a) it is a regulated market;
  - (b) it has 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;
- (73) '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;

- (74) 'mortgage lending value' means the value of 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;
- (75) 'residential property' means a residence which is occupied by the owner or the lessee of the residence, including the right to inhabit an apartment in housing cooperatives located in Sweden;
- (76) '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 being under compulsion;
- (77) 'applicable accounting framework' means the accounting standards to which the institution is subject under Regulation (EC) No 1606/2002 or Directive 86/635/EEC;
- (78) '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;
- (79) 'speculative immovable property financing' means loans for the purposes of the acquisition of or development or construction on land in relation to immovable property, or of and in relation to such property, with the intention of reselling for profit;
- (80) 'trade finance' means financing, including guarantees, connected to the exchange of goods and services through financial products of fixed short-term maturity, generally of less than one year, without automatic rollover;
- (81) 'officially supported export credits' means loans or credits to finance the export of goods and services for which an official export credit agency provides guarantees, insurance or direct financing;
- (82) '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;
- (83) 'repurchase transaction' means any transaction governed by a repurchase agreement or a reverse repurchase agreement;
- (84) 'simple repurchase agreement' means a repurchase transaction of a single asset, or of similar, non-complex assets, as opposed to a basket of assets;
- (85) '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;
- (86) '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;
- (87) 'multilateral trading facility' means multilateral trading facility as defined in point 15 of Article 4 of Directive 2004/39/EC;
- (88) 'qualifying central counterparty' means a central counterparty that has been either authorised in accordance with Article 14 of Regulation (EU) No 648/2012 or recognised in accordance with Article 25 of that Regulation;
- (89) 'default fund' means a fund established by a CCP in accordance with Article 42 of Regulation (EU) No 648/2012 and used in accordance with Article 45 of that Regulation;

- (90) '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;
- (91) 'trade exposure' means a current exposure, including a variation margin due to the clearing member but not yet received, and any potential future exposure of a clearing member or a client, to a CCP arising from contracts and transactions listed in points (a) to (e) of Article 301(1), as well as initial margin;
- (92) 'regulated market' means regulated market as defined in point (14) of Article 4 of Directive 2004/39/EC;
- (93) '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;
- (94) 'risk of excessive leverage' means the risk resulting from an institution's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets;
- (95) 'credit risk adjustment' means the amount of specific and general loan loss provision for credit risks that has been recognised in the financial statements of the institution in accordance with the applicable accounting framework;
- (96) '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;
- (97) 'reference obligation' means an obligation used for the purposes of determining the cash settlement value of a credit derivative;
- (98) 'external credit assessment institution' or 'ECAI' means a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies<sup>(1)</sup> or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009;
- (99) 'nominated ECAI' means an ECAI nominated by an institution;
- (100) 'accumulated other comprehensive income' has the same meaning as under International Accounting Standard (IAS) 1, as applicable under Regulation (EC) No 1606/2002;
- (101) 'basic own funds' means basic own funds within the meaning of Article 88 of Directive 2009/138/EC;
- (102) '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 Article 94(1) of that Directive;
- (103) 'additional 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 Article 94(1) of that Directive and the inclusion of those items is limited by the delegated acts adopted in accordance with Article 99 of that Directive;
- (104) '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 in Tier 2 within the meaning of Directive 2009/138/EC in accordance with Article 94(2) of that Directive;
- (105) '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 in Tier 3 within the meaning of Directive 2009/138/EC in accordance with Article 94(3) of that Directive;
- (106) 'deferred tax assets' has the same meaning as under the applicable accounting framework;
- (107) 'deferred tax assets that rely on future profitability' means deferred tax assets the future value of which may be realised only in the event the institution generates taxable profit in the future;
- (108) 'deferred tax liabilities' has the same meaning as under the applicable accounting framework;
- (109) '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;

<sup>(1)</sup> OJ L 302, 17.11.2009, p. 1.

- (110) 'distributions' means the payment of dividends or interest in any form;
- (111) 'financial undertaking' has the same meaning as under points (25)(b) and (d) of Article 13 of Directive 2009/138/EC;
- (112) 'funds for general banking risk' has the same meaning as under Article 38 of Directive 86/635/EEC;
- (113) 'goodwill' has the same meaning as under the applicable accounting framework;
- (114) 'indirect holding' means any exposure to 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;
- (115) 'intangible assets' has the same meaning as under the applicable accounting framework and includes goodwill;
- (116) '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;
- (117) 'other reserves' means reserves within the meaning of the applicable accounting framework that are required to be disclosed under the applicable accounting standard, excluding any amounts already included in accumulated other comprehensive income or retained earnings;
- (118) 'own funds' means the sum of Tier 1 capital and Tier 2 capital;
- (119) 'own funds instruments' means capital instruments issued by the institution that qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments;
- (120) 'minority interest' means the amount of Common Equity Tier 1 capital of a subsidiary of an institution that is attributable to natural or legal persons other than those included in the prudential scope of consolidation of the institution;
- (121) 'profit' has the same meaning as under the applicable accounting framework;
- (122) '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;
- (123) 'retained earnings' means profits and losses brought forward as a result of the final application of profit or loss under the applicable accounting framework;
- (124) 'share premium account' has the same meaning as under the applicable accounting framework;
- (125) 'temporary differences' has the same meaning as under the applicable accounting framework;
- (126) '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;
- (127) 'cross-guarantee scheme' means a scheme that meets all the following conditions:
- (a) the institutions fall within the same institutional protection scheme as referred to in Article 113(7);
  - (b) the institutions are fully consolidated in accordance with Article 1(1)(b), (c) or (d) or Article 1(2) of Directive 83/349/EEC and are included in the supervision on a consolidated basis of an institution which is a parent institution in a Member State in accordance with Part One, Title II, Chapter 2 of this Regulation and subject to own funds requirements;
  - (c) the parent institution in a Member State and the subsidiaries are established in the same Member State and are subject to authorisation and supervision by the same competent authority;
  - (d) the parent institution in a Member State and the subsidiaries have entered into a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency, in order to avoid bankruptcy in the case that it becomes necessary;



- (e) arrangements are in place to ensure the prompt provision of financial means in terms of capital and liquidity if required under the contractual or statutory liability arrangement referred to in point (d);
- (f) the adequacy of the arrangements referred to in points (d) and (e) is monitored on a regular basis by the competent authority;
- (g) the minimum period of notice for a voluntary exit of a subsidiary from the liability arrangement is 10 years;
- (h) the competent authority is empowered to prohibit a voluntary exit of a subsidiary from the liability arrangement;
- (128) 'distributable items' means the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's bye-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statutes of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts.

2. Where reference in this Regulation is made to real estate or residential or commercial immovable property or a mortgage on such property, it shall include shares in Finnish residential housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation. Member States or their competent authorities may allow shares constituting an equivalent indirect holding of real estate to be treated as a direct holding of real estate provided that such an indirect holding is specifically regulated in the national law of the Member State concerned and that, when pledged as collateral, it provides equivalent protection to creditors.

3. Trade finance as referred to in point (80) of paragraph 1 is generally uncommitted and requires satisfactory supporting transactional documentation for each drawdown request enabling refusal of the finance in the event of any doubt about credit-worthiness or the supporting transactional documentation. Repayment of trade finance exposures is usually independent of the borrower, the funds instead coming from cash received from importers or resulting from proceeds of the sales of the underlying goods.

#### Article 5

#### Definitions specific to capital requirements for credit risk

For the purposes of Part Three, Title II, the following definitions shall apply:

- (1) 'exposure' means an asset or off-balance sheet item;
- (2) 'loss' means economic loss, including material discount effects, and material direct and indirect costs associated with collecting on the instrument;
- (3) 'expected loss' or 'EL' 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.

#### TITLE II

#### LEVEL OF APPLICATION OF REQUIREMENTS

#### CHAPTER 1

#### *Application of requirements on an individual basis*

#### Article 6

#### General principles

1. Institutions shall comply with the obligations laid down in Parts Two to Five and Eight 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 19, shall not be required to comply with the obligations laid down in Articles 89, 90 and 91 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 19, shall not be required 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 and activities 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 508(3), 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 the investment firms' activities.
5. Institutions, except for investment firms referred to in Article 95(1) and Article 96(1) and institutions for which competent authorities have exercised the derogation specified in Article 7(1) or (3), shall comply with the obligations laid down in Part Seven on an individual basis.

*Article 7***Derogation to the application of prudential requirements on an individual basis**

1. Competent authorities may waive the application of Article 6(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 between the parent undertaking and the subsidiary:

- (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 11(1).

3. Competent authorities may waive the application of Article 6(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 8***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 an institution and to all or some of its subsidiaries in the 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;
- (b) the parent institution on a consolidated basis or the 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 a sufficient level of liquidity for all of these institutions;
- (c) the institutions have entered into contracts that, to the satisfaction of the competent authorities, 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).

By 1 January 2014 the Commission shall report to the European Parliament and the Council on any legal obstacles which are capable of rendering impossible the application of point (c) of the first subparagraph and is invited to make a legislative proposal, if appropriate, by 31 December 2015 on which of those obstacles should be removed.

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 authorised in the same Member State and provided that the conditions in paragraph 1 are fulfilled.

3. 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 21 and only to the institutions whose competent authorities agree about the following elements:

- (a) their assessment of the compliance of the organisation and of the treatment of liquidity risk with the conditions set out in Article 86 of Directive 2013/36/EU across the single liquidity sub-group;
- (b) the distribution of amounts, location and ownership of the required liquid assets to be held within the single liquidity sub-group;
- (c) the determination of 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;
- (e) unrestricted sharing of complete information between the competent authorities;
- (f) a full understanding of the implications of such a waiver.

4. Competent authorities may also apply paragraphs 1, 2 and 3 to institutions which are members of the same institutional protection scheme referred to in Article 113(7)(b), provided that they meet all the conditions laid down in Article 113(7), and to other institutions linked by a relationship referred to in Article 113(6) provided that they meet all the conditions laid down therein. 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 sub-group.

5. Where a waiver has been granted under paragraph 1 or paragraph 2, the competent authorities may also apply Article 86 of Directive 2013/36/EU, or parts thereof, at the level of the single liquidity sub-group and waive the application of Article 86 of Directive 2013/36/EU, or parts thereof, on an individual basis.

#### Article 9

##### Individual consolidation method

1. Subject to paragraphs 2 and 3 of this Article and to Article 144(3) of Directive 2013/36/EU, the competent authorities may permit on a case by case basis parent institutions to incorporate in the calculation of their requirement under Article 6(1) subsidiaries which meet the conditions laid down in points (c) and (d) of Article 7(1), and whose material exposures or material liabilities are to that parent institution.

2. The treatment set out 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 10

##### Waiver for credit institutions permanently affiliated to a central body

1. Competent authorities may, in accordance with national law, partially or fully waive the application of the requirements set out in Parts Two 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.

Member States may maintain and make use of existing national legislation regarding the application of the waiver referred to in the first subparagraph as long as it does not conflict with this Regulation and Directive 2013/36/EU.

2. Where the competent authorities are satisfied that the conditions set out in paragraph 1 are met, and where the liabilities or commitments of the central body are entirely guaranteed by the affiliated institutions, the competent authorities may waive the application of Parts Two to Eight to the central body on an individual basis.

## CHAPTER 2

**Prudential consolidation**

## Section 1

**Application of requirements on a consolidated basis**

## Article 11

**General treatment**

1. Parent institutions in a Member State shall comply, to the extent and in the manner prescribed in Article 18, with the obligations laid down in Parts Two to Four and Part 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 18, with the obligations laid down in Parts Two to Four and Part 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 111 of Directive 2013/36/EU.

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 and activities listed in points (3) and (6) of Section A of Annex I to Directive 2004/39/EC. Pending the report from the Commission in accordance with Article 508(2), and if the group comprises only investment firms, competent authorities may exempt investment firms from compliance with the obligations laid down in Part Six on a consolidated basis, taking into account the nature, scale and complexity of the investment firm's activities.

4. Where Article 10 is applied, the central body referred to in that Article shall comply with the requirements of Parts Two to Eight on the basis of the consolidated situation of the whole as constituted by the central body together with its affiliated institutions.

5. In addition to the requirements in paragraphs 1 to 4, and without prejudice to other provisions of this Regulation and Directive 2013/36/EU, when it is justified for supervisory purposes by the specificities of the risk or of the capital structure of an institution or where Member States adopt national laws requiring the structural separation of activities within a banking group, competent authorities may require the structurally separated institutions to comply with the obligations laid down in Parts Two to Four and Parts Six to Eight of this Regulation and in Title VII of Directive 2013/36/EU on a sub-consolidated basis.

Applying the approach set out in the first subparagraph shall be without prejudice to effective supervision on a consolidated basis and shall neither entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the Union as a whole nor form or create an obstacle to the functioning of the internal market.

## Article 12

**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 13

**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 which are of material significance for their local market shall disclose the information specified in Articles 437, 438, 440, 442, 450, 451 and 453, 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 and those subsidiaries which are of material significance for their local market shall disclose the information specified in Articles 437, 438, 440, 442, 450, 451 and 453 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 10 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 18(1) shall apply to the central body and the affiliated institutions shall be treated as the subsidiaries of the central body.

#### Article 14

##### **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 407 when applying Article 92 on a consolidated or sub-consolidated basis if the requirements of Articles 405 or 406 are breached at the level of an entity established in a third country included in the consolidation in accordance with Article 18 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 15

##### **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 of this Regulation and Title VII, Chapter 4 of Directive 2013/36/EU 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 95(2);
- (b) all investment firms in the group fall within the categories in Articles 95(1) and 96(1);
- (c) each EU investment firm in the group meets the requirements imposed in Article 95 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 26(1), 51(1) and 62(1), as to cover the sum of the following:
  - (i) the sum of the full book value of any holdings, subordinated claims and instruments referred to in Article 36(1)(h) and (i), Article 56(1)(c) and (d), and Article 66(1)(c) and (d) in investment firms, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated; and
  - (ii) 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 16

### **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 6(5), the parent investment firm may choose not to apply the requirements laid down in Part Seven on a consolidated basis.

#### Article 17

### **Supervision of investment firms waived from the application of own funds requirements on a consolidated basis**

1. Investment firms in a group which has been granted the waiver provided for in Article 15 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.

2. Where the competent authorities responsible for the prudential supervision of the investment firm waive the obligation of supervision on a consolidated basis as provided for in Article 15, 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.

3. Where the competent authorities responsible for the prudential supervision of the investment firm waive the application of own funds requirements on a consolidated basis as provided for in Article 15, the requirements of Part Eight shall apply on an individual basis.

## Section 2

### **Methods for prudential consolidation**

#### Article 18

### **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 applies 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.

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

8. Where consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU, ancillary services undertakings and asset management companies as defined in point (5) of Article 2 of 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 19

#### 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 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 111 of Directive 2013/36/EU 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 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 20

#### 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 Article 143(1), Article 151(4) and (9), Article 283, Article 312(2) and Article 363 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 intragroup treatment as referred to in Article 422(9) and Article 425(5) complemented by the EBA regulatory technical standards referred to in Article 422(10) and Article 425(6) are met.

Applications shall be submitted only to the consolidating supervisor.

The application referred to in Article 312(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 point (a) of paragraph 1;
- (b) the assessment of the criteria and the determination of the specific treatment referred to in point (b) of paragraph 1.

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 point (a) of paragraph 1 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 intragroup 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 point (a) of paragraph 1. The decision of the consolidating supervisor shall not limit the powers of the competent authorities under Article 105 of Directive 2013/36/EU.

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 point (a) of paragraph 1 of this Article 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 one 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. 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 point (b) of paragraph 1.

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 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 point (b) of paragraph 1 of this Article 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 one 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.

6. 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 312(2) or an IRB Approach referred to in Article 143 on a unified basis, the competent authorities shall allow the qualifying criteria set out in Articles 321 and 322 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.

7. The decisions referred to in paragraphs 2, 4 and 5 shall be recognised as determinative and applied by the competent authorities in the Member States concerned.

8. EBA shall develop draft implementing technical standards to specify the joint decision process referred to in point (a) of paragraph 1, with regard to the applications for permissions referred to in Article 143(1), Article 151(4) and (9), Article 283, Article 312(2), and Article 363 with a view to facilitating joint decisions.

EBA 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 Article 15 of Regulation (EU) No 1093/2010.

#### Article 21

### **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 on whether the conditions in points (a) to (d) of Article 8(1) are met and identifying a single liquidity sub-group for the application of Article 8.

The 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 8. 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 institutions that are exempt from the application of Part Six.

The 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 in points (a) to (d) of Article 8(1) are met. In that case, EBA may carry out its non-binding mediation in accordance with Article 31(c) of Regulation (EU) No 1093/2010 and 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 three months, each competent authority responsible for supervision on an individual basis shall take its own decision taking into account the proportionality of benefits and risks at the level of the Member State of the parent institution and the proportionality of benefits and risks at the level of the Member State of the subsidiary. 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 decisions referred to in the second subparagraph of this paragraph shall be binding.

3. Any relevant competent authority may also during the six months period consult EBA in the event of a disagreement on the conditions in points (a) to (d) of Article 8(3). In that case, EBA may carry out its non-binding mediation in accordance with Article 31(c) of Regulation (EU) No 1093/2010, and 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 three months, each competent authority responsible for supervision on an individual basis shall take its own decision.

#### Article 22

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

Subsidiary institutions shall apply the requirements laid down in Articles 89 to 91 and Parts Three and Five 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 23

### 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 4.

#### Article 24

### Valuation of assets and off-balance sheet items

1. The valuation of assets and off-balance sheet items shall be effected in accordance with the applicable accounting framework.

2. By way of derogation from paragraph 1, competent authorities may require that institutions effect the valuation of assets and off-balance sheet items and the determination of own funds in accordance with International Accounting Standards as applicable under Regulation (EC) No 1606/2002.

## PART TWO

### OWN FUNDS

#### TITLE I

### ELEMENTS OF OWN FUNDS

#### CHAPTER 1

### Tier 1 capital

#### Article 25

### 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 26

### 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 28 or, where applicable, Article 29 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.

The items referred to in points (c) to (f) shall be recognised as Common Equity Tier 1 only where they are available to the institution for unrestricted and immediate use to cover risks or losses as soon as these occur.

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 permission of the competent authority. The competent authority shall grant permission 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 verification 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. Competent authorities shall evaluate whether issuances of Common Equity Tier 1 instruments meet the criteria set out in Article 28 or, where applicable, Article 29. With respect to issuances after 31 December 2014, institutions shall classify capital instruments as Common Equity Tier 1 instruments only after permission is granted by the competent authorities, which may consult EBA.



For capital instruments, with the exception of State aid, that are approved as eligible for classification as Common Equity Tier 1 instruments by the competent authority but where, in the opinion of EBA, the compliance with the criteria in Article 28 or, where applicable, Article 29, is materially complex to ascertain, the competent authorities shall explain their reasoning to EBA.

On the basis of information from each competent authority, EBA shall establish, maintain and publish a list of all the forms of capital instruments in each Member State that qualify as Common Equity Tier 1 instruments. EBA shall establish that list and publish it by 1 February 2015 for the first time.

EBA may, after the review process set out in Article 80 and, where there is significant evidence of those instruments not meeting the criteria set out in Article 28 or, where applicable, Article 29, decide to remove non-State aid capital instruments issued after 31 December 2014 from the list and may make an announcement to that effect.

4. 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 February 2015.

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

#### Article 27

### **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 any of the following:
  - (i) a mutual;
  - (ii) a cooperative society;
  - (iii) a savings institution;
  - (iv) a similar institution;

- (v) a credit institution which is wholly owned by one of the institutions referred to in points (i) to (iv) and has approval from the relevant competent authority to make use of the provisions in this Article, provided that, and for as long as, 100 % of the ordinary shares in issue in the credit institution are held directly or indirectly by an institution referred to in those points;

- (b) the conditions laid down in Articles 28 or, where applicable, Article 29, are met.

Those mutuals, cooperative societies or savings institutions recognised as such under applicable national law prior to 31 December 2012 shall continue to be classified as such for the purposes of this Part, provided that they continue to meet the criteria that determined such recognition.

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 February 2015.

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

#### Article 28

### **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 framework;
- (iii) they are classified as equity capital for the purposes of determining balance sheet insolvency, where applicable under national insolvency law;
- (d) the instruments are clearly and separately disclosed on the balance sheet in the financial statements of the institution;
- (e) the instruments are perpetual;
- (f) the principal amount of the instruments may not be reduced or repaid, except in either of the following cases:
  - (i) the liquidation of the institution;
  - (ii) discretionary repurchases of the instruments or other discretionary means of reducing capital, where the institution has received the prior permission of the competent authority in accordance with Article 77;
- (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 27 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 is no preferential distribution treatment regarding the order of distribution payments, including in relation to other Common Equity Tier 1 instruments, and the terms governing the instruments do not provide preferential rights to payment of distributions;
  - (ii) distributions to holders of the instruments may be paid only out of distributable items;
  - (iii) the conditions governing the instruments do not include a cap or other restriction on the maximum level of distributions, except in the case of the instruments referred to in Article 27;
  - (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 27;
- (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 27;
- (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) the parent financial holding company or its subsidiaries;
  - (iv) the mixed activity holding company or its subsidiaries;
  - (v) the mixed financial holding company and its subsidiaries;
  - (vi) any undertaking that has close links with the entities referred to in points (i) to (v);
- (m) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of claims under the instruments in insolvency or liquidation.

The condition set out in point (j) of the first subparagraph shall be deemed to be met, notwithstanding the instruments are included in Additional Tier 1 or Tier 2 by virtue of Article 484(3), provided that they rank *pari passu*.

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

The condition laid down in point (f) of paragraph 1 shall be deemed to be met notwithstanding the reduction of the principal amount of the capital instrument within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority responsible for the institution.

The condition laid down in point (g) of paragraph 1 shall be deemed to be met notwithstanding the provisions governing the capital instrument indicating expressly or implicitly that the principal amount of the instrument would or might be reduced within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority responsible for the institution.

3. The condition laid down in point (h)(iii) of paragraph 1 shall be deemed to be met notwithstanding the instrument paying a dividend multiple, provided that such a dividend multiple does not result in a distribution that causes a disproportionate drag on own funds.

4. For the purposes of point (h)(i) of paragraph 1, differentiated distributions shall only reflect differentiated voting rights. In this respect, higher distributions shall only apply to Common Equity Tier 1 instruments with fewer or no voting rights.

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

- (a) the applicable forms and nature of indirect funding of own funds instruments;
- (b) Whether and when multiple distributions would constitute a disproportionate drag on own funds;
- (c) the meaning of preferential distributions.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

#### Article 29

#### **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 28 with modifications resulting from the 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 subparagraph is without prejudice to the possibility for a mutual, cooperative society, savings institution or a similar institution to recognize within Common Equity Tier 1 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 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 February 2015.

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

#### Article 30

##### **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 28 or, where applicable, Article 29 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.

#### Article 31

##### **Capital instruments subscribed by public authorities in emergency situations**

1. In emergency situations, competent authorities may permit institutions to include in Common Equity Tier 1 capital instruments that comply at least with the conditions laid down in points (b) to (e) of Article 28(1) where all the following conditions are met:

- (a) the capital instruments are issued after 1 January 2014;
- (b) the capital instruments are considered State aid by the Commission;
- (c) the capital instruments are issued within the context of recapitalisation measures pursuant to State aid- rules existing at the time;

(d) the capital instruments are fully subscribed and held by the State or a relevant public authority or public-owned entity;

(e) the capital instruments are able to absorb losses;

(f) except for the capital instruments referred to in Article 27, in the event of liquidation, the capital instruments entitle their owners to a claim on the residual assets of the institution after the payment of all senior claims;

(g) there are adequate exit mechanisms of the State or, where applicable, a relevant public authority or public-owned entity;

(h) the competent authority has granted its prior permission and has published its decision together with an explanation of that decision.

2. Upon reasoned request by and in cooperation with the relevant competent authority, EBA shall consider the capital instruments referred to in paragraph 1 as equivalent to Common Equity Tier 1 instruments for the purposes of this Regulation.

#### Section 2

##### **Prudential filters**

#### Article 32

##### **Securitised assets**

1. An institution shall exclude from any element of own funds any increase in its equity under the applicable accounting framework 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 February 2015.

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

*Article 33***Cash flow hedges and changes in the value of own liabilities**

1. 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;
- (c) all fair value gains and losses arising from the institution's own credit risk related to derivative liabilities.

2. For the purposes of point (c) of paragraph 1, institutions shall not offset the fair value gains and losses arising from the institution's own credit risk with those arising from its counterparty credit risk.

3. Without prejudice to point (b) of paragraph 1, institutions may include the amount of gains and losses on their liabilities in own funds where all the following conditions are met:

- (a) the liabilities are in the form of bonds as referred to in Article 52(4) of Directive 2009/65/EC;
- (b) the changes in the value of the institution's assets and liabilities are due to the same changes in the institution's own credit standing;
- (c) there is a close correspondence between the value of the bonds referred to in point (a) and the value of the institution's assets;
- (d) it is possible to redeem the mortgage loans by buying back the bonds financing the mortgage loans at market or nominal value.

4. EBA shall develop draft regulatory technical standards to specify what constitutes close correspondence between the value of the bonds and the value of the assets, as referred to in point (c) of paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 30 September 2013.

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

*Article 34***Additional value adjustments**

Institutions shall apply the requirements of Article 105 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.

*Article 35***Unrealised gains and losses measured at fair value**

Except in the case of the items referred to in Article 33, 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 36***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 (the IRB Approach), negative amounts resulting from the calculation of expected loss amounts laid down in Articles 158 and 159;
- (e) defined benefit pension fund assets on the balance sheet 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 56 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 the amount of Common Equity Tier 1 items as an alternative to applying a risk weight of 1 250 %:
- (i) qualifying holdings outside the financial sector;
  - (ii) securitisation positions, in accordance with Article 243(1)(b), Article 244(1)(b) and Article 258;
  - (iii) free deliveries, in accordance with Article 379(3);
  - (iv) positions in a basket for which an institution cannot determine the risk weight under the IRB Approach, in accordance with Article 153(8);
  - (v) equity exposures under an internal models approach, in accordance with Article 155(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 used 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 of this Article and related deductions referred to in points (a), (c), (d) and (f) of Article 56 and points (a), (c) and (d) of Article 66.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

3. EBA shall develop draft regulatory technical standards to specify the types of capital instruments of financial institutions and, in consultation with the European Supervisory Authority (European Insurance and Occupational Pensions Authority) (EIOPA) established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010<sup>(1)</sup>, of third country insurance and reinsurance undertakings, and of 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:

- (a) Common Equity Tier 1 items;
- (b) Additional Tier 1 items;
- (c) Tier 2 items.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

#### Article 37

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

<sup>(1)</sup> OJ L 331, 15.12.2010, p. 48.

#### Article 38

##### **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 a legally enforceable right under applicable national law to set off those current tax assets against current tax liabilities;
- (b) the deferred tax assets and the deferred tax liabilities relate to 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 Article 48(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 39

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

1. 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.

2. 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), (b) and (c) are met.

#### Article 40

##### **Deduction of negative amounts resulting from the calculation of expected loss amounts**

The amount to be deducted in accordance with point (d) of Article 36(1) shall not be reduced by a rise in the level of deferred tax assets that rely on future profitability, or other additional tax effects, that could occur if provisions were to rise to the level of expected losses referred to in Section 3 of Chapter 3 of Title I.

#### Article 41

##### **Deduction of defined benefit pension fund assets**

1. For the purposes of point (e) of Article 36(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 framework;

(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 February 2015.

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

#### Article 42

##### **Deduction of holdings of own Common Equity Tier 1 instruments**

For the purposes of point (f) of Article 36(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 that both the following conditions are met:

(i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;

(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, provided that both the following conditions are met:

(i) the long and short positions are in the same underlying indices;

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book.

#### Article 43

##### **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 framework.

#### Article 44

##### **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 36(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 45

**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 36(1) in accordance with the following provisions:

- (a) they may calculate direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of the financial sector entities on the basis of the net long position in the same underlying exposure provided that both the following conditions are met:
  - (i) the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year;
  - (ii) either both the long position and the short position are held in the trading book or both are held in the non-trading book;
- (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 46

**Deduction of holdings of Common Equity Tier 1 instruments where an institution does not have a significant investment in a financial sector entity**

1. For the purposes of point (h) of Article 36(1), institutions shall calculate the applicable amount to be deducted by multiplying the amount referred to in point (a) of this paragraph by the factor derived from the calculation referred to in point (b) of this paragraph:

- (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 aggregate amount of Common Equity Tier 1 items of the institution calculated after applying the following to Common Equity Tier 1 items:
  - (i) Articles 32 to 35;
  - (ii) the deductions referred to in points (a) to (g), points (k)(ii) to (v) and point (l) of Article 36(1), excluding the

amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;

(iii) Articles 44 and 45;

- (b) the amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of those financial sector entities in which the institution does not have a significant investment 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 five 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 all Common Equity Tier 1 instruments held. Institutions shall determine the portion of holdings of Common Equity Tier 1 instruments that is deducted pursuant to paragraph 1 by multiplying the amount specified in point (a) of this paragraph by the proportion specified in point (b) of this paragraph:

- (a) the amount of holdings required to be deducted pursuant to paragraph 1;
- (b) the proportion of 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 represented by each Common Equity Tier 1 instrument held.

4. The amount of holdings referred to in point (h) of Article 36(1) that is equal to or less than 10 % of the Common Equity Tier 1 items of the institution after applying the provisions laid down in points (a)(i) to (iii) of paragraph 1 shall not be deducted and shall be subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and the requirements laid down in Title IV of Part Three, as applicable.

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

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

(b) the amount specified in point (i) divided by the amount specified in point (ii):

- (i) the total amount of the Common Equity Tier 1 instruments;
- (ii) 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.

#### Article 47

### **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 36(1), the applicable amount to be deducted from Common Equity Tier 1 items shall exclude underwriting positions held for five working days or fewer and shall be determined in accordance with Articles 44 and 45 and Sub-section 2.

#### Sub-Section 2

### **Exemptions from and alternatives to deduction from Common Equity Tier 1 items**

#### Article 48

### **Threshold exemptions from deduction from Common Equity Tier 1 items**

1. In making the deductions required pursuant to points (c) and (i) of Article 36(1), institutions are not required to deduct the amounts of the items listed in points (a) and (b) of this paragraph which in aggregate are equal to or less than the threshold amount referred to in paragraph 2:

- (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 32 to 35;
  - (ii) points (a) to (h), points (k)(ii) to (v) and point (l) of Article 36(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 32 to 35;
- (ii) points (a) to (h), points (k)(ii) to (v) and point (l), of Article 36(1) excluding deferred tax assets that rely on future profitability and arise from temporary differences.

2. For the purposes of paragraph 1, the threshold amount shall be equal to the amount referred to in point (a) of this paragraph multiplied by the percentage referred to in point (b) of this paragraph:

- (a) the residual amount of Common Equity Tier 1 items after applying the adjustments and deductions in Articles 32 to 36 in full and without applying the threshold exemptions specified in this Article;
- (b) 17,65 %.

3. For the purposes of paragraph 1, an institution shall determine the portion of deferred tax assets in the total amount of items that is not required to be deducted by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:

- (a) the amount of 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;
- (b) the sum of the following:
  - (i) the amount referred to in point (a);
  - (ii) the amount of direct, indirect and synthetic holdings by the institution of the own funds instruments of financial sector entities in which the institution has a significant investment, and in aggregate are equal to or less than 10 % of the Common Equity Tier 1 items of the institution.

The proportion of significant investments in the total amount of items that is not required to be deducted is equal to one minus the proportion referred to in the first subparagraph.

4. The amounts of the items that are not deducted pursuant to paragraph 1 shall be risk weighted at 250 %.



## Article 49

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

1. For the purposes of calculating own funds on an individual basis, a sub-consolidated basis and a consolidated basis, where the competent authorities require or permit institutions to apply method 1, 2 or 3 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) of this paragraph are met:

- (a) the financial sector entity is an insurance undertaking, a re-insurance undertaking or an insurance holding company;
- (b) that insurance undertaking, re-insurance undertaking or 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 consolidation under method 1, 2 or 3 is adequate;
- (e) the holdings in the entity belong 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 an individual 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 of own funds instruments issued by financial sector entities included in the scope of consolidated supervision, unless the competent authorities determine those deductions to be required for specific purposes, in particular structural separation of banking activities and resolution planning.

Applying the approach referred to in the first subparagraph shall not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the Union as a whole forming or creating an obstacle to the functioning of the internal market.

3. Competent authorities may, for the purposes of calculating own funds on an individual or sub-consolidated basis permit institutions not to deduct holdings of own funds instruments in the following cases:

- (a) where an institution has a holding in another institution and the conditions referred to in points (i) to (v) are met:
  - (i) the institutions fall within the same institutional protection scheme referred to in Article 113(7);
  - (ii) the competent authorities have granted the permission referred to in Article 113(7);
  - (iii) the conditions laid down in Article 113(7) are satisfied;
  - (iv) the institutional protection scheme draws up a consolidated balance sheet referred to in point (e) of Article 113(7) or, where it is not required to draw up consolidated accounts, an extended aggregated calculation that is, to the satisfaction of the competent authorities, equivalent to the provisions of Directive 86/635/EEC, which incorporates certain adaptations of the provisions of Directive 83/349/EEC or of Regulation (EC) No 1606/2002, governing the consolidated accounts of groups of credit institutions. The equivalence of that extended aggregated calculation shall be verified by an external auditor and in particular that the multiple use of elements eligible for the calculation of own funds as well as any inappropriate creation of own funds between the members of the institutional protection scheme is eliminated in the calculation. The consolidated balance sheet or the extended aggregated calculation shall be reported to the competent authorities no less frequently than the frequency laid down in Article 99;

- (v) the institutions included in an institutional protection scheme meet together on a consolidated or extended aggregated basis the requirements laid down in Article 92 and carry out reporting of compliance with those requirements in accordance with Article 99. Within an institutional protection scheme the deduction of the interest owned by co-operative members or legal entities, which are not members of the institutional protection scheme, is not required, provided that the multiple use of elements eligible for the calculation of own funds as well as any inappropriate creation of own funds between the members of the institutional protection scheme and the minority shareholder, when it is an institution, is eliminated.

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

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

5. Where an institution applies methods 1 or 2 of Annex I to Directive 2002/87/EC, the institution shall disclose the supplementary own funds requirement and capital adequacy ratio of the financial conglomerate as calculated in accordance with Article 6 of and Annex I to that Directive.

6. EBA, EIOPA and the European Supervisory Authority (European Securities and Markets Authority) (ESMA) established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010<sup>(1)</sup> 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 of Directive 2002/87/EC for the purposes of the alternatives to deduction referred to in paragraph 1 of this Article.

EBA, EIOPA and ESMA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010, of Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 respectively.

<sup>(1)</sup> OJ L 331, 15.12.2010, p. 84.

## Section 4

### Common equity tier 1 capital

#### Article 50

#### 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 Articles 32 to 35, the deductions pursuant to Article 36 and the exemptions and alternatives laid down in Articles 48, 49 and 79.

## CHAPTER 3

### Additional Tier 1 capital

#### Section 1

### Additional tier 1 items and instruments

#### Article 51

#### Additional Tier 1 items

Additional Tier 1 items shall consist of the following:

- (a) capital instruments, where the conditions laid down in Article 52(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 52

#### 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) an undertaking in which the institution has 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 claims by any of the following:
- (i) the institution or its subsidiaries;
  - (ii) the parent undertaking of the institution or its subsidiaries;
  - (iii) the parent financial holding company or its subsidiaries;
  - (iv) the mixed activity holding company or its subsidiaries;
  - (v) the mixed financial holding company or its subsidiaries;
  - (vi) any undertaking that has close links with entities referred to in points (i) to (v);
- (f) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of the claim under the instruments in insolvency or liquidation;
- (g) the instruments are perpetual and the provisions governing them include no incentive for the institution to redeem them;
- (h) where the provisions governing the instruments include one or more call options, the option to call may be exercised at the sole discretion of the issuer;
- (i) the instruments may be called, redeemed or repurchased only where the conditions laid down in Article 77 are met, and not before five years after the date of issuance except where the conditions laid down in Article 78(4) 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, except in the following cases:
- (i) the liquidation of the institution;
  - (ii) discretionary repurchases of the instruments or other discretionary means of reducing the amount of Additional Tier 1 capital, where the institution has received the prior permission of the competent authority in accordance with Article 77;
- (k) the institution does not indicate explicitly or implicitly that the competent authority would consent to a request to call, redeem or repurchase the instruments;
- (l) distributions under the instruments meet the following conditions:
- (i) they are paid out of distributable items;
  - (ii) the level of distributions made on the instruments will not be amended on the basis of 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 that, upon the occurrence of a trigger event, the principal amount of the instruments be written down on a permanent or temporary basis or the instruments be converted to Common Equity Tier 1 instruments;
- (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 an institution, both the following conditions shall be met:
- (i) the instruments are issued through an entity within the consolidation pursuant to Chapter 2 of Title II of Part One;
  - (ii) the proceeds are immediately available to the institution without limitation and in a form that satisfies the conditions laid down in this paragraph.

The condition set out in point (d) of the first subparagraph shall be deemed to be met notwithstanding the instruments are included in Additional Tier 1 or Tier 2 by virtue of Article 484(3), provided that they rank *pari passu*.

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) 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 February 2015.

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

#### Article 53

#### **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 52(1), the provisions governing Additional Tier 1 instruments shall, 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 54

#### **Write down or conversion of Additional Tier 1 instruments**

1. For the purposes of point (n) of Article 52(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 92(1) falls below either of the following:
  - (i) 5,125 %;
  - (ii) a level higher than 5,125 %, where determined by the institution and specified in the provisions governing the instrument;
- (b) institutions may specify in the provisions governing the instrument one or more trigger events in addition to that referred to in point (a);
- (c) 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;
- (d) 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 framework, 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:

(a) immediately inform the competent authorities;

(b) inform the holders of the Additional Tier 1 instruments;

(c) write down the principal amount of the instruments, or convert the instruments into Common Equity Tier 1 instruments without delay, but no later than in one month, in accordance with the requirement laid down in this Article.

6. An institution issuing Additional Tier 1 instruments that convert to Common Equity Tier 1 on the occurrence of a trigger event shall ensure that its authorised share capital is at all times sufficient, for converting all such convertible Additional Tier 1 instruments into shares if a trigger event occurs. All necessary authorisations shall be obtained at the date of issuance of such convertible Additional Tier 1 instruments. The institution shall maintain at all times the necessary prior authorisation to issue the Common Equity Tier 1 instruments into which such Additional Tier 1 instruments would convert upon occurrence of a trigger event.

7. An institution issuing Additional Tier 1 instruments that convert to Common Equity Tier 1 on the occurrence of a trigger event shall ensure that there are no procedural impediments to that conversion by virtue of its incorporation or statutes or contractual arrangements.

#### Article 55

#### 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 52(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 an Additional Tier 1 item.

#### Section 2

#### Deductions from additional tier 1 items

#### Article 56

#### 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 60 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 five working days or fewer;

(e) the amount of items required to be deducted from Tier 2 items pursuant to Article 66 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 57

#### **Deductions of holdings of own Additional Tier 1 instruments**

For the purposes of point (a) of Article 56, 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 that both the following conditions are met:
- (i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;
  - (ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;
- (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) institutions may net gross long positions in own Additional Tier 1 instruments resulting from holdings of index securities 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, provided that both the following conditions are met:
- (i) the long and short positions are in the same underlying indices;
  - (ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;

#### Article 58

#### **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 56 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 59

#### **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 56 in accordance with the following:

- (a) they may calculate direct, indirect and synthetic holdings of Additional Tier 1 instruments of the financial sector entities on the basis of the net long position in the same underlying exposure provided that both the following conditions are met:
- (i) the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year;
  - (ii) either both the short position and the long position are held in the trading book or both are held in the non-trading book.
- (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 60

#### **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 56, institutions shall calculate the applicable amount to be deducted by multiplying the amount referred to in point (a) of this paragraph by the factor derived from the calculation referred to in point (b) of this paragraph:

- (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 32 to 35;

- (ii) points (a) to (g), points (k)(ii) to (v) and point (l) of Article 36(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;
- (iii) Articles 44 and 45;
- (b) the amount of direct, indirect and synthetic holdings by the institution of the Additional Tier 1 instruments of those financial sector entities in which the institution does not have a significant investment 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 five 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 all Additional Tier 1 instruments held. The amount to be deducted from each Additional Tier 1 instrument pursuant to paragraph 1 shall be calculated by multiplying the amount specified in point (a) of this paragraph by the proportion specified in point (b) of this paragraph:
- (a) the amount of holdings required to be deducted pursuant to paragraph 1;
- (b) the amount specified in point (i) divided by the amount specified in point (ii):
- (i) the total amount of the Additional Tier 1 instrument;
- (ii) 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.
4. The amount of holdings referred to in point (c) of Article 56 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), (ii) and (iii) of paragraph 1 shall not be deducted and shall be subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and the requirements laid down in Title IV of Part Three, as applicable.
5. Institutions shall determine the portion of holdings of own funds instruments that is risk weighted by dividing the amount specified in point (a) by the amount specified in point (b):
- (a) the amount of holdings required to be risk weighted pursuant to paragraph 4;
- (b) the amount specified in point (i) divided by the amount specified in point (ii):
- (i) the total amount of the Common Equity Tier 1 instruments;
- (ii) 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.

### Section 3

#### **Additional Tier 1 capital**

##### *Article 61*

#### **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 56 and the application of Article 79.

### CHAPTER 4

#### **Tier 2 capital**

##### Section 1

#### **Tier 2 items and instruments**

##### *Article 62*

#### **Tier 2 items**

Tier 2 items shall consist of the following:

- (a) capital instruments and subordinated loans where the conditions laid down in Article 63 are met;
- (b) the share premium accounts related to instruments referred to in point (a);
- (c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 2 of Title II of Part Three, 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 of Part Three, positive amounts, gross of tax effects, resulting from the calculation laid down in Articles 158 and 159 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 63*

**Tier 2 instruments**

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

- (a) the instruments are issued or the subordinated loans are raised, as applicable, and fully paid-up;
- (b) the instruments are not purchased or the subordinated loans are not granted, as applicable, by any of the following:
  - (i) the institution or its subsidiaries;
  - (ii) an undertaking in which the institution has participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of that undertaking;
- (c) the purchase of the instruments or the granting of the subordinated loans, as applicable, 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 or the claim of the principal amount of the subordinated loans under the provisions governing the subordinated loans, as applicable, is wholly subordinated to claims of all non-subordinated creditors;
- (e) the instruments or subordinated loans, as applicable, 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) the parent financial holding company or its subsidiaries;
  - (iv) the mixed activity holding company or its subsidiaries;
  - (v) the mixed financial holding company or its subsidiaries;
  - (vi) any undertaking that has close links with entities referred to in points (i) to (v);
- (f) the instruments or subordinated loans, as applicable, are not subject to any arrangement that otherwise enhances the seniority of the claim under the instruments or subordinated loans respectively;
- (g) the instruments or subordinated loans, as applicable, have an original maturity of at least five years;
- (h) the provisions governing the instruments or subordinated loans, as applicable, do not include any incentive for their principal amount to be redeemed or repaid, as applicable by the institution prior to their maturity;
- (i) where the instruments or subordinated loans, as applicable, include one or more call options or early repayment options, as applicable, the options are exercisable at the sole discretion of the issuer or debtor, as applicable;
- (j) the instruments or subordinated loans, as applicable, may be called, redeemed or repurchased or repaid early only where the conditions laid down in Article 77 are met, and not before five years after the date of issuance or raising, as applicable, except where the conditions laid down in Article 78(4) are met;
- (k) the provisions governing the instruments or subordinated loans, as applicable, do not indicate explicitly or implicitly that the instruments or subordinated loans, as applicable, would or might be called, redeemed, repurchased or repaid early, as applicable 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 or subordinated loans, as applicable, 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, as applicable, due on the instruments or subordinated loans, as applicable, will not be amended on the basis of the credit standing of the institution or its parent undertaking;
- (n) where the instruments are not issued directly by an institution, or where the subordinated loans are not raised directly by an institution, as applicable, both of the following conditions shall be met:
  - (i) the instruments are issued or subordinated loans are raised, as applicable, through an entity, which is part of the consolidation pursuant to Chapter 2 of Title II of Part One;

- (ii) the proceeds are immediately available to the institution without limitation in a form that satisfies the conditions laid down in this paragraph.

#### Article 64

##### Amortisation of Tier 2 instruments

The extent to which Tier 2 instruments qualify as Tier 2 items during the final five years of maturity of the instruments is calculated by multiplying the result derived from the calculation in point (a) by the amount referred to in point (b) as follows:

- (a) the nominal amount of the instruments or subordinated loans on the first day of the final five year period of their contractual maturity divided by the number of calendar days in that period;
- (b) the number of remaining calendar days of contractual maturity of the instruments or subordinated loans.

#### Article 65

##### 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 63 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 66

##### 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 70 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 five working days.

#### Article 67

##### Deductions of holdings of own Tier 2 instruments

For the purposes of point (a) of Article 66, institutions shall calculate holdings on the basis of the gross long positions subject to the following exceptions:

- (a) institutions may calculate the amount of holdings on the basis of the net long position provided that both the following conditions are met:
  - (i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;
  - (ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;
- (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, provided that both the following conditions are met:
  - (i) the long and short positions are in the same underlying indices;
  - (ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book.

*Article 68***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 66 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 69***Deduction of holdings of Tier 2 instruments of financial sector entities**

Institutions shall make the deductions required by points (c) and (d) of Article 66 in accordance with the following:

- (a) they may calculate direct, indirect and synthetic holdings of Tier 2 instruments of the financial sector entities on the basis of the net long position in the same underlying exposure provided that both the following conditions are met:
  - (i) the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year;
  - (ii) either both the long position and the short position are held in the trading book or both are held in the non-trading book;
- (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 70***Deduction of Tier 2 instruments where an institution does not have a significant investment in a relevant entity**

1. For the purposes of point (c) of Article 66, institutions shall calculate the applicable amount to be deducted by multiplying the amount referred to in point (a) of this paragraph by the factor derived from the calculation referred to in point (b) of this paragraph:

- (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 32 to 35;
- (ii) points (a) to (g), points (k)(ii) to (v) and point (l) of Article 36(1), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;
- (iii) Articles 44 and 45;
- (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 five 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 multiplying the amount specified in point (a) of this paragraph by the proportion specified in point (b) of this paragraph:

- (a) the total amount of holdings required to be deducted pursuant to paragraph 1;
- (b) the amount specified in point (i) divided by the amount specified in point (ii):
  - (i) the total amount of the Tier 2 instrument;
  - (ii) the 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.

4. The amount of holdings referred to in point (c) of Article 66(1) that is equal to or less than 10 % of the Common Equity Tier 1 items of the institution after applying the provisions laid down in points (a)(i) to (iii) of paragraph 1 shall not be deducted and shall be subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and the requirements laid down in Title IV of Part Three, as applicable.



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

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

(b) the amount specified in point (i) divided by the amount specified in point (ii):

(i) the total amount of the Common Equity Tier 1 instruments;

(ii) 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.

### Section 3

#### Tier 2 capital

##### Article 71

#### 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 66 and the application of Article 79.

### CHAPTER 5

#### Own funds

##### Article 72

#### 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 73

#### 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 by 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 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 standing 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. Institutions shall report and disclose the broad market indices on which their capital instruments rely.

7. EBA shall develop draft regulatory technical standards to specify the conditions according to which indices shall be deemed to qualify as broad market indices for the purposes of paragraph 4.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

#### Article 74

##### **Holdings of capital instruments issued by regulated 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 capital instruments issued by a regulated financial sector entity that do not qualify as regulatory capital of that entity. Institutions shall apply risk weights to such holdings in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.

#### Article 75

##### **Deduction and maturity requirements for short positions**

The maturity requirements for short positions referred to in point (a) of Article 45, point (a) of Article 59 and point (a) of Article 69 shall be deemed to be met in respect of positions held 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 76

##### **Index holdings of capital instruments**

1. For the purposes of point (a) of Article 42, point (a) of Article 45, point (a) of Article 57, point (a) of Article 59, point (a) of Article 67 and point (a) of Article 69, institutions may reduce the amount of a long position in a capital instrument by the portion of an index that is made up of the same underlying exposure that is being hedged, provided the following conditions are met:

- (a) either both the long position being hedged and the short position in an index used to hedge that long position are held in the trading book or both are held in the non-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.

2. 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) Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities, included in indices.

3. Competent authorities shall grant the permission referred to in paragraph 2 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 point (a) or (b) of paragraph 2, as applicable.

4. EBA shall develop draft regulatory technical standards to specify:

- (a) when an estimate used as an alternative to the calculation of underlying exposure referred to in paragraph 2 is sufficiently conservative;
- (b) the meaning of operationally burdensome for the purposes of paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

#### Article 77

##### **Conditions for reducing own funds**

An institution shall require the prior permission of the competent authority to do either or both of 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, repayment or repurchase of Additional Tier 1 instruments or Tier 2 instruments as applicable, prior to the date of their contractual maturity.

(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;

#### Article 78

##### 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 77, the institution replaces the instruments referred to in Article 77 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 92(1) of this Regulation and the combined buffer requirement as defined in point (6) of Article 128 of Directive 2013/36/EU by a margin that the competent authority may consider necessary on the basis of Article 104(3) of Directive 2013/36/EU.

2. When assessing under point (a) of paragraph 1 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.

3. Where an institution takes an action referred to in point (a) of Article 77 and the refusal of redemption of Common Equity Tier 1 instruments referred to in Article 27 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.

4. The competent authorities may permit institutions to redeem Additional Tier 1 or Tier 2 instruments before five years of 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;

(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.

5. 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 3;

(c) the process and data requirements for an application by an institution for the permission of the competent authority to carry out an action listed in Article 77, 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 February 2015.

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

#### Article 79

##### Temporary waiver from deduction from own funds

1. Where an institution holds capital instruments or has granted subordinated loans, as applicable, 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. EBA shall develop draft regulatory technical standards to specify the concept of temporary for the purposes of paragraph 1 and the conditions according to which a competent authority may deem those temporary holdings to be for the purposes of a financial assistance operation designed to reorganise and save a relevant entity.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

#### Article 80

##### 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 those instruments not meeting the criteria set out in Article 28 or, where applicable, Article 29.

Competent authorities shall, without delay, upon request by EBA, forward all information that EBA deems relevant concerning new capital instruments issued in order to enable EBA to monitor the quality of own funds instruments issued by institutions across the Union.

2. A notification shall include the following:

- (a) a detailed explanation of the nature and extent of the shortfall identified;
- (b) technical advice on the action by the Commission that EBA considers to be necessary;
- (c) significant developments in the methodology of EBA for stress testing the solvency of institutions.

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 1 January 2014 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 II

##### MINORITY INTEREST AND ADDITIONAL TIER 1 AND TIER 2 INSTRUMENTS ISSUED BY SUBSIDIARIES

#### Article 81

##### Minority interests that qualify for inclusion in consolidated Common Equity Tier 1 capital

1. Minority interests shall comprise the sum of Common Equity Tier 1 instruments, the share premium accounts related to those instruments, retained earnings 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 2013/36/EU;
- (b) the subsidiary is included fully in the consolidation pursuant to Chapter 2 of Title II of Part One;
- (c) the Common Equity Tier 1 items, referred to in the introductory part of this paragraph 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 82

##### 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 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 2013/36/EU;
- (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 83

#### **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 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 share premium accounts, are included in qualifying Additional Tier 1 capital only where the conditions laid down in Article 52(1) are satisfied;
- (c) the instruments, and the related share premium accounts, are included in qualifying Tier 2 capital only where the conditions laid down in Article 63 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 II of Part One, the form of which satisfies the relevant conditions laid down in Articles 52(1) or 63, 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) of the first subparagraph.

2. EBA shall develop draft regulatory technical standards to specify the types of assets that can relate to the operation of special purpose entities and the concepts of minimal and insignificant referred to in the second subparagraph of paragraph 1.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

#### Article 84

#### **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 92(1), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in Article 104 of Directive 2013/36/EU the combined buffer requirement defined in point (6) of Article 128 of Directive 2013/36/EU, the requirements referred to in Article 500 and any additional local supervisory regulations in third countries insofar as those requirements are to be met by Common Equity Tier 1 capital;
- (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 92(1), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in Article 104 of Directive 2013/36/EU, the combined buffer requirement defined in point (6) of Article 128 of Directive 2013/36/EU, the requirements referred to in Article 500 and any additional local supervisory regulations in third countries insofar as those requirements are to be met by Common Equity Tier 1 capital.

- (b) the minority interests of the subsidiary expressed as a percentage of all Common Equity Tier 1 instruments of that undertaking plus the related share premium accounts, retained earnings 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 81(1).

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 81(1). Where an institution takes such a decision, the minority interest of that subsidiary may not be included in consolidated Common Equity Tier 1 capital.



3. Where a competent authority derogates from the application of prudential requirements on an individual basis, as laid down in Article 7, minority interest within the subsidiaries to which the waiver is applied shall not be recognised in own funds at the sub-consolidated or at the consolidated level, as applicable.

4. EBA shall develop draft regulatory technical standards to specify the sub-consolidation calculation required in accordance with paragraph 2 of this Article, Articles 85 and 87.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

5. Competent authorities may grant a waiver from the application of this Article to a parent financial holding company that satisfies all the following conditions:

- (a) its principal activity is to acquire holdings;
- (b) it is subject to prudential supervision on a consolidated basis;
- (c) it consolidates a subsidiary institution in which it has only a minority holding by virtue of the control relationship defined in Article 1 of Directive 83/349/EEC;
- (d) more than 90 % of the consolidated required Common Equity Tier 1 capital arises from the subsidiary institution referred to in point c) calculated on a sub-consolidated basis.

Where, after 31 December 2014, a parent financial holding company that meets the conditions laid down in the first subparagraph becomes a parent mixed financial holding company, competent authorities may grant the waiver referred to in the first subparagraph to that parent mixed financial holding company provided that it meets the conditions laid down in that subparagraph.

6. Where credit institutions permanently affiliated in a network to a central body and institutions established within an institutional protection scheme subject to the conditions laid down in Article 113(7) have set up a cross-guarantee scheme that provides that there is no current or foreseen material, practical or legal impediment to the transfer of the amount of own funds above the regulatory requirements from the counterparty to the credit institution, these institutions are

exempted from the provisions of this Article regarding deductions and may recognise any minority interest arising within the cross-guarantee scheme in full.

#### Article 85

### Qualifying Tier 1 instruments included in consolidated Tier 1 capital

1. 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 92(1), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in Article 104 of Directive 2013/36/EU, the combined buffer requirement defined in point (6) of Article 128 of Directive 2013/36/EU, the requirements referred to in Article 500 and any additional local supervisory regulations in third countries insofar as those requirements are to be met by Tier 1 Capital;
  - (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 92(1), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in Article 104 of Directive 2013/36/EU, the combined buffer requirement defined in point (6) of Article 128 of Directive 2013/36/EU, the requirements referred to in Article 500 and any additional local supervisory regulations in third countries insofar as those requirements are to be met by Tier 1 Capital;
- (b) the qualifying Tier 1 capital of the subsidiary expressed as a percentage of all Tier 1 instruments of that undertaking plus the related share premium accounts, retained earnings 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 81(1).

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 81(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.

3. Where a competent authority derogates from the application of prudential requirements on an individual basis, as laid down in Article 7, Tier 1 instruments within the subsidiaries to which the waiver is applied shall not be recognised in own funds at the sub-consolidated or at the consolidated level, as applicable.

#### Article 86

### Qualifying Tier 1 capital included in consolidated Additional Tier 1 capital

Without prejudice to Article 84 (5) and (6)), 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 87

### 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 92(1), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in Article 104 of Directive 2013/36/EU, the combined buffer requirement defined in point (6) of Article 128 of Directive 2013/36/EU, the requirements referred to in Article 500 and any additional local supervisory regulations in third countries;
- (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 92(1), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in Article 104 of Directive 2013/36/EU, the combined buffer requirement defined in point (6) of Article 128 of Directive 2013/36/EU, the requirements referred to in Article 500 and any additional local supervisory own funds requirement in third countries;

(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 share premium accounts, the retained earnings 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 81(1).

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 81(1). Where an institution takes such a decision, the qualifying own funds of that subsidiary may not be included in consolidated own funds.

3. Where a competent authority derogates from the application of prudential requirements on an individual basis, as laid down in Article 7, own funds instruments within the subsidiaries to which the waiver is applied shall not be recognised in own funds at the sub-consolidated or at the consolidated level, as applicable.

#### Article 88

### Qualifying own funds instruments included in consolidated Tier 2 capital

Without prejudice to Article 84(5) and (6), 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 III

### QUALIFYING HOLDINGS OUTSIDE THE FINANCIAL SECTOR

#### Article 89

### 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 any of the following:
  - (i) a direct extension of banking;
  - (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 points (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 capital requirement in accordance with Part Three, 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.

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

4. For the purposes of point (b) of paragraph 1, EBA shall issue guidelines specifying the following concepts:

(a) activities that are a direct extension of banking;

(b) activities ancillary to banking;

(c) similar activities.

Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.

#### Article 90

##### 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 Article 89(1) and (2), institutions may deduct those amounts from Common Equity Tier 1 items in accordance with point (k) of Article 36(1).

#### Article 91

##### Exceptions

1. Shares of undertakings not referred to in points (a) and (b) of Article 89(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 assistance operation as referred to in Article 79;

(b) the holding of those shares is an underwriting position held for five 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 referred to in Article 35(2) of Directive 86/635/EEC shall not be included in the calculation specified in Article 89.

### 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 92

#### **Own funds requirements**

1. Subject to Articles 93 and 94, 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) of this paragraph 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 and Article 379, 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 this Part 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 395 to 401, to the extent an institution is permitted to exceed those limits;

(c) the own funds requirements determined in accordance with Title IV or Title V with the exception of Article 379, 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 for operational risk;

(f) the risk weighted exposure amounts determined in accordance with Title II for counterparty risk arising from the trading book business of the institution for the following types of transactions and agreements:

(i) contracts listed in Annex II 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), (d) and (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 93

##### 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 out 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.

3. Authorised investment firms and firms that were covered by Article 6 of Directive 2006/49/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 out 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 Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions<sup>(1)</sup>. 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.

4. Where control of an institution falling within the category referred to in paragraph 2 or 3 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.

<sup>(1)</sup> OJ L 141, 11.6.1993, p. 1.

5. Where there is a merger of two or more institutions falling within the category referred to in paragraph 2 or 3, 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.

6. 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 5 shall not apply.

#### Article 94

##### **Derogation for small trading book business**

1. Institutions may replace the capital requirement referred to in point (b) of Article 92(3) 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 both the following conditions:

(a) is normally less than 5 % of the total assets and EUR 15 million;

(b) never exceeds 6 % of total assets and EUR 20 million.

2. In calculating the size of on- and off-balance sheet business, institutions shall apply the following:

(a) 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;

(b) the absolute value of long positions shall be summed with the absolute value of short positions.

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 95

##### **Own funds requirements for investment firms with limited authorisation to provide investment services**

1. For the purposes of Article 92(3), investment firms that are not authorised to provide the investment services and

activities 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 of this Article and firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC 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 92(3) after applying Article 92(4);

(b) 12,5 multiplied by the amount specified in Article 97.

Firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC shall meet the requirements in Article 92(1) and (2) based on the total risk exposure amount referred to in the first subparagraph.

Competent authorities may set the own fund requirements for firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC as the own fund requirements that would be binding on those firms according to the national transposition measures in force on 31 December 2013 for Directives 2006/49/EC and 2006/48/EC.

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 2013/36/EU.

#### Article 96

##### **Own funds requirements for investment firms which hold initial capital as laid down in Article 28(2) of Directive 2013/36/EU**

1. For the purposes of Article 92(3), the following categories of investment firm which hold initial capital in accordance with Article 28(2) of Directive 2013/36/EU shall use the calculation of the total risk exposure amount specified in paragraph 2 of this Article:

(a) investment firms that deal on own account only for the purpose of fulfilling or executing a client order or for the purpose of gaining entrance to a clearing and settlement system or a recognised exchange when acting in an agency capacity or executing a client order;



(b) investment firms that meet all the following conditions:

- (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 92(3) after applying Article 92(4);
- (b) the amount referred to in Article 97 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 II, Sub-section 1 of Directive 2013/36/EU.

#### Article 97

##### Own Funds based on Fixed Overheads

1. In accordance with Articles 95 and 96, an investment firm and firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC shall hold eligible capital of at least one quarter of the fixed overheads of 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 March 2014.

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

#### Article 98

##### Own funds for investment firms on a consolidated basis

1. In the case of the investment firms referred to in Article 95(1) in a group, where that group does not include credit institutions, a parent investment firm in a Member State shall apply Article 92 at a consolidated level as follows:

- (a) using the calculation of total risk exposure amount specified in Article 95(2);
- (b) own funds calculated on the basis of the consolidated situation of the parent investment firm or that of the financial holding company or mixed financial holding company, as applicable.

2. In the case of investment firms referred to in Article 96(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 or mixed financial holding company shall apply Article 92 on a consolidated basis as follows:

- (a) it shall use the calculation of total risk exposure amount specified in Article 96(2);
- (b) it shall use own funds calculated on the basis of the consolidated situation of the parent investment firm or that of the financial holding company or mixed financial holding company, as applicable, and in compliance with Chapter 2 of Title II of Part One.

## CHAPTER 2

**Calculation and reporting requirements**

## Article 99

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

1. Reporting by institutions to the competent authorities on the obligations laid down in Article 92 shall be carried out at least on a semi-annual basis.

2. Institutions subject to Article 4 of Regulation (EC) No 1606/2002 and credit institutions other than those referred to in Article 4 of that Regulation that prepare their consolidated accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2) of that Regulation, shall also report financial information.

3. Competent authorities may require those credit institutions applying international accounting standards as applicable under Regulation (EC) No 1606/2002 for the reporting of own funds on a consolidated basis pursuant to Article 24(2) of this Regulation to also report financial information as laid down in paragraph 2 of this Article.

4. The financial information referred to in paragraph 2 and in the first subparagraph of paragraph 3 shall be reported to the extent this is necessary to obtain a comprehensive view of the risk profile of an institution's activities and 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.

5. EBA shall develop draft implementing technical standards to specify the uniform formats, frequencies, dates of reporting, definitions and the IT solutions to be applied in the Union for the reporting referred to in paragraphs 1 to 4.

The reporting requirements 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 February 2015.

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

6. Where a competent authority considers that the financial information required by paragraph 2 is necessary to obtain a

comprehensive view of the risk profile of the activities of, and a view of the systemic risks to the financial sector or the real economy posed by, institutions other than those referred to in paragraphs 2 and 3 that are subject to an accounting framework based on Directive 86/635/EEC, the competent authority shall consult EBA on the extension of the reporting requirements of financial information on a consolidated basis to those institutions, provided that they are not already reporting on such a basis.

EBA shall develop draft implementing technical standards to specify the formats to be used by institutions to which the competent authorities may extend the reporting requirements in accordance with the first subparagraph.

EBA shall submit those draft implementing technical standards to the Commission by 1 February 2015.

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

7. Where a competent authority considers information not covered by the implementing technical standards referred to in paragraph 5 to be necessary for the purposes set out in paragraph 4, it shall notify EBA and the ESRB about the additional information it deems necessary to include in the implementing technical standards referred to in paragraph 5.

## Article 100

**Additional reporting requirements**

Institutions shall report to the competent authorities the level, at least in aggregate terms, of their repurchase agreements, securities lending and all forms of encumbrance of assets.

EBA shall include this information in the implementing technical standards on reporting referred to in Article 99(5).

## Article 101

**Specific reporting obligations**

1. Institutions shall report on a semi-annual 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 124(2);

- (b) overall losses stemming from exposures for which an institution has recognised immovable residential property as collateral, up to the part of the exposure treated as fully secured by immovable residential property in accordance with Article 124(1);
- (c) 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 in accordance with Article 124(1);
- (d) 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 124(2);
- (e) 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 in accordance with Article 124(1).
- (f) 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 in accordance with Article 124(1).

2. The data referred to in paragraph 1 shall be reported to the competent authority of the home Member State of the relevant institution. Where an institution has a branch in another Member State, the data relating to that branch shall also be reported to the competent authorities of the host Member State. The data shall be reported separately for each property market within the Union to which the relevant institution is exposed.

3. The competent authorities shall publish annually on an aggregated basis the data specified in points (a) to (f) 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 EBA provide to that competent authority or EBA more detailed information on the condition of the residential or commercial immovable property markets in that Member State.

4. EBA shall develop draft implementing technical standards to specify the following:

- (a) uniform formats, definitions, frequencies and dates of reporting, as well as the IT solutions, of the items referred to in paragraph 1;

- (b) uniform formats, definitions, frequencies and dates of reporting, as well as IT solutions, of the aggregate data referred to in paragraph 2.

EBA shall submit those draft implementing technical standards to the Commission by 1 February 2015.

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

### CHAPTER 3

#### **Trading book**

##### *Article 102*

#### **Requirements for the Trading Book**

1. Positions in the trading book shall be either free of restrictions on their tradability or able to be hedged.
2. Trading intent shall be evidenced on the basis of the strategies, policies and procedures set up by the institution to manage the position or portfolio in accordance with Article 103.
3. Institutions shall establish and maintain systems and controls to manage their trading book in accordance with Articles 104 and 105.
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 103 to 106 are met.

##### *Article 103*

#### **Management of the trading book**

In managing its positions or sets of positions in the trading book the institution shall comply with all of the following requirements:

- (a) the institution shall have in place a clearly documented trading strategy for the position/instrument or portfolios, approved by senior management, which shall include the expected holding period;
- (b) the institution shall have in place clearly defined policies and procedures for the active management of positions entered into on a trading desk. Those policies and procedures shall include the following:
  - (i) which positions may be entered into by which trading desk;

- (ii) position limits are set and monitored for appropriateness;
  - (iii) dealers have the autonomy to enter into and manage the position within agreed limits and according to the approved strategy;
  - (iv) positions are reported to senior management as an integral part of the institution's risk management process;
  - (v) positions are actively monitored with reference to market information sources and an assessment made of the marketability or hedge-ability of the position or its component risks, including the assessment, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market;
  - (vi) active anti fraud procedures and controls.
- (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.
- (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 104

##### 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 102 and the definition of trading book in accordance with point (86) of Article 4(1), 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;

#### Article 105

##### Requirements for Prudent Valuation

1. All trading book positions shall be subject to the standards for prudent valuation specified in this Article. Institutions shall in particular ensure that the prudent valuation of their trading book positions achieves an appropriate degree of certainty having regard to the dynamic nature of trading book positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions.
2. Institutions shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates. Those systems and controls shall include at least the following elements:
  - (a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the institution's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures;
  - (b) reporting lines for the department accountable for the valuation process that are clear and independent of the front office.

The reporting line shall ultimately be to the management body.

3. Institutions shall revalue trading book positions at least daily.

4. Institutions shall mark their positions to market whenever possible, including when applying trading book capital treatment.

5. When marking to market, an institution shall use the more prudent side of bid and offer unless the institution can close out at mid market. Where institutions make use of this derogation, they shall every six months inform their competent authorities of the positions concerned and furnish evidence that they can close out at mid-market.

6. Where marking to market is not possible, institutions shall conservatively mark to model their positions and portfolios, including when calculating own funds requirements for positions in the trading book.

7. Institutions shall comply with the following requirements when marking to model:

(a) senior management shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the materiality of the uncertainty thereby created in the reporting of the risk/performance of the business;

(b) institutions shall source market inputs, where possible, in line with market prices, and shall assess the appropriateness of the market inputs of the particular position being valued and the parameters of the model on a frequent basis;

(c) where available, institutions shall use valuation methodologies which are accepted market practice for particular financial instruments or commodities;

(d) where the model is developed by the institution itself, it shall be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process;

(e) institutions shall have in place formal change control procedures and shall hold a secure copy of the model and use it periodically to check valuations;

(f) risk management shall be aware of the weaknesses of the models used and how best to reflect those in the valuation output; and

(g) institutions' 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 105 shall be applied for the purposes of paragraph 1 of this Article.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

#### *Article 106*

#### **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 299(2), 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 107*

#### **Approaches to credit risk**

1. Institutions shall apply either the Standardised Approach provided for in Chapter 2 or, if permitted by the competent authorities in accordance with Article 143, 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 92(3).
2. For trade exposures and for default fund contributions to a central counterparty, institutions shall apply the treatment set out in Chapter 6, Section 9 to calculate their risk-weighted exposure amounts for the purposes of points (a) and (f) of Article 92(3). For all other types of exposures to a central counterparty, institutions shall treat those exposures as follows:
  - (a) as exposures to an institution for other types of exposures to a qualifying CCP;
  - (b) as exposures to a corporate for other types of exposures to a non-qualifying CCP.

3. For the purposes of this Regulation, exposures to third-country investment firms and exposures to third country credit institutions and exposures to third country clearing houses and exchanges shall be treated as exposures to an institution only if the third country applies prudential and supervisory requirements to that entity that are at least equivalent to those applied in the Union.

4. For the purposes of paragraph 3, the Commission may adopt, by way of implementing acts, and subject to the examination procedure referred to in Article 464(2), a decision as to whether a third country applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union. In the absence of such a decision, until 1 January 2015, institutions may continue to treat exposures to the entities referred to in paragraph 3 as exposures to institutions provided that the relevant competent authorities had approved the third country as eligible for that treatment before 1 January 2014.

#### Article 108

##### **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 loss given default (LGD) and conversion factors under Article 151, 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 92(3) or, as relevant, expected loss amounts for the purposes of the calculation referred to in point (d) of Article 36(1) and point (c) of Article 62.

2. For an exposure to which an institution applies the IRB Approach by using their own estimates of LGD and conversion factors under Article 151, the institution may use credit risk mitigation in accordance with Chapter 3.

#### Article 109

##### **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 112, it shall calculate the risk-weighted exposure amount for a securitisation position in accordance with Articles 245, 246 and 251 to 258. Institutions using the Standardised Approach may also use the Internal Assessment Approach where this has been permitted under Article 259(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 147 it shall calculate the risk-weighted exposure amount in accordance with Articles 245, 246 and 259 to 266.

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 110

##### **Treatment of credit risk adjustment**

1. Institutions applying the Standardised Approach shall treat general credit risk adjustments in accordance with Article 62(c).

2. Institutions applying the IRB Approach shall treat general credit risk adjustments in accordance with Article 159, Article 62(d) and Article 36(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 Articles 148 and 150 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 111;
- (b) exposure value under the IRB Approach referred to in Articles 166 to 168;
- (c) treatment of expected loss amounts referred to in Article 159;
- (d) exposure value for the calculation of the risk-weighted exposure amounts for securitisation position referred to in Articles 246 and 266;
- (e) the determination of default under Article 178.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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

## CHAPTER 2

### **Standardised Approach**

#### Section 1

### **General principles**

#### Article 111

#### **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 Articles 34 and 110 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 223, 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 223 to 225.

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 amended in accordance with Chapter 4.

#### Article 112

#### **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;

- |  |  |
|--|--|
| <ul style="list-style-type: none"> <li>(k) exposures associated with particularly high risk;</li> <li>(l) exposures in the form of covered bonds;</li> <li>(m) items representing securitisation positions;</li> <li>(n) exposures to institutions and corporates with a short-term credit assessment;</li> <li>(o) exposures in the form of units or shares in collective investment undertakings ('CIUs');</li> <li>(p) equity exposures;</li> <li>(q) other items.</li> </ul> | <ul style="list-style-type: none"> <li>(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;</li> <li>(b) the counterparty is included in the same consolidation as the institution on a full basis;</li> <li>(c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the institution;</li> <li>(d) the counterparty is established in the same Member State as the institution;</li> <li>(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.</li> </ul> |
|--|--|

#### *Article 113*

#### **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 ECAs 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 amended 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:

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 permission of the competent authorities, not apply the requirements of paragraph 1 of this Article to exposures to counterparties with which the institution has entered into an institutional protection scheme that is a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy where necessary. Competent authorities are empowered to grant permission 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 178(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 points (c) and (d) is approved and monitored at regular intervals by the relevant competent authorities.

Where the institution, in accordance with this paragraph, decides not to apply the requirements of paragraph 1, it may assign a risk weight of 0 %.

## Section 2

### Risk weights

#### Article 114

##### 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 7 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 136.

Table 1

Credit quality step	1	2	3	4	5	6
Risk weight	0 %	20 %	50 %	100 %	100 %	150 %

3. Exposures to the ECB 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. Until 31 December 2017, 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.
6. For exposures indicated in paragraph 5:
- (a) in 2018 the calculated risk weighted exposure amounts shall be 20 % of the risk weight assigned to these exposures in accordance with Article 114(2);
- (b) in 2019 the calculated risk weighted exposure amounts shall be 50 % of the risk weight assigned to these exposures in accordance with Article 114(2);
- (c) in 2020 and onwards the calculated risk weighted exposure amounts shall be 100 % of the risk weight assigned to these exposures in accordance with Article 114(2).

7. 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 464(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 2015, 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 that treatment before 1 January 2014.



### Article 115

#### 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 Article 119(2) and Article 120(2) shall not be applied.

2. Exposures to regional governments or local authorities shall be treated as exposures to the central government in whose jurisdiction they are established where there is no difference in risk between such exposures because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default.

EBA shall maintain a publicly available database of all regional governments and local authorities within the Union which relevant competent authorities treat as exposures to their central governments.

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. In this case, paragraph 2 shall not apply and, for the purposes of Article 150(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 464(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 2015, 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 that treatment before 1 January 2014.

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 116

#### 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 in accordance with Article 120. The preferential treatment for short-term exposures specified in Articles 119(2) and 120(2), shall not be applied to those entities.

3. For exposures to public sector entities with an original maturity of three 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 in accordance with 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 464(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 2015, 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 that treatment before 1 January 2014.

#### Article 117

##### 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 119(2), 120(2) and 121(3) shall not be applied.

The Inter-American Investment Corporation, the Black Sea Trade and Development Bank, the Central American Bank for Economic Integration and the CAF-Development Bank of Latin America shall be considered multilateral development banks.

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 118

##### Exposures to international organisations

Exposures to the following international organisations shall be assigned a 0 % risk weight:

- (a) the Union;
- (b) the International Monetary Fund;
- (c) the Bank for International Settlements;
- (d) the European Financial Stability Facility;
- (e) the European Stability Mechanism;
- (f) 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 119

##### 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 120. Exposures to institutions for which a credit assessment by a nominated ECAI is not available shall be risk-weighted in accordance with Article 121.

2. Exposures to institutions of a residual maturity of three 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 Article 114(4) to (7), assigned to exposures to the central government in which the institution is incorporated.

3. No exposures with a residual maturity of three 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 <sup>(1)</sup> 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 120

##### 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 136.

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 136:

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 131 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 121

##### 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 %.

<sup>(1)</sup> OJ L 250, 2.10.2003, p. 10.

4. Notwithstanding paragraphs 2 and 3, for trade finance exposures referred to in point (b) of the second subparagraph of Article 162(3) to unrated institutions, the risk weight shall be 50 % and where the residual maturity of these trade finance exposures to unrated institutions is three months or less, the risk weight shall be 20 %.

#### Article 122

##### 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 136.

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 123

##### 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 (SME);
- (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 and completely secured on residential property collateral that have been assigned to the exposure class laid down in point (i) of Article 112, 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 referred to in points (a) to (c) of the first subparagraph 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 124

##### 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 125 and Article 126 are not met, except for any part of the exposure which is assigned to another exposure class. The part of the exposure that exceeds the mortgage value of the property shall be assigned the risk weight applicable to the unsecured exposures of the counterparty involved.

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 101, 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 125 and the risk weight of 50 % for exposures secured on commercial immovable property referred to in Article 126 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 125(2) and Article 126(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 %,

For exposures secured on commercial immovable property, the competent authority shall set the risk weight at a percentage from 50 % through 150 %,

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 125(2) and Article 126(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 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 in this paragraph as specified by the regulatory technical standards referred to in paragraph 4 of this Article. EBA shall publish the risk weights and criteria that the competent authorities set for exposures referred to in Articles 125, 126 and 199.

3. When competent authorities set a higher risk weight or stricter criteria, institutions shall have a 6-month transitional period to apply the new risk weight.

4. EBA shall develop draft 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 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

5. 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 125

#### **Exposures fully and completely secured by mortgages on residential property**

1. Unless otherwise decided by the competent authorities in accordance with Article 124(2), exposures fully and completely secured by mortgages on residential property shall be treated as follows:

- (a) exposures or any part of an exposure fully and completely secured by mortgages on residential property which is or shall be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, shall be assigned a risk weight of 35 %;
- (b) exposures 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 208 and the valuation rules set out in Article 229(1) are met;
- (d) unless otherwise determined under Article 124(2), the part of the loan to which the 35 % risk weight is assigned does not exceed 80 % of the market value of the property in question or 80 % of the mortgage lending value 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) of 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 124(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 point (b) of paragraph 2 shall apply until the conditions in paragraph 3 are satisfied in a subsequent year.

#### Article 126

#### **Exposures fully and completely secured by mortgages on commercial immovable property**

1. Unless otherwise decided by the competent authorities in accordance with Article 124(2), exposures fully and completely secured by mortgages on commercial immovable property shall be treated as follows:

- (a) exposures or any part of an exposure fully and completely secured by mortgages on offices or other commercial premises may be assigned a risk weight of 50 %;
- (b) exposures 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 208 and the valuation rules set out in Article 229(1) are met;
- (d) The 50 % risk weight unless otherwise provided under Article 124(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 124(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) of 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 124(2), do not exceed 0,3 % of the outstanding loans collateralised by commercial immovable property;
- (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.

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 point (b) of paragraph 2 shall apply until the conditions in paragraph 3 are satisfied in a subsequent year.

*Article 127***Exposures in default**

1. The unsecured part of any item where the obligor has defaulted in accordance with Article 178, or in the case of retail exposures, the unsecured part of any credit facility which has defaulted in accordance with Article 178 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. The exposure value remaining after specific credit risk adjustments of exposures fully and completely secured by mortgages on residential property in accordance with Article 125 shall be assigned a risk weight of 100 % if a default has occurred in accordance with Article 178.

4. The exposure value remaining after specific credit risk adjustments of exposures fully and completely secured by mortgages on commercial immovable property in accordance with Article 126 shall be assigned a risk weight of 100 % if a default has occurred in accordance with Article 178.

*Article 128***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 CIU 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 AIFs as defined in Article 4(1)(a) of Directive 2011/61/EU except where the mandate of the fund does not allow a leverage higher than that required under Article 51(3) of Directive 2009/65/EC;
- (c) investments in private equity;
- (d) 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.

Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.

*Article 129***Exposures in the form of covered bonds**

1. To be eligible for the preferential treatment set out in paragraphs 4 and 5, bonds as referred to in Article 52(4) of Directive 2009/65/EC (covered bonds) shall meet the requirements set out in paragraph 7 and shall be collateralised by any of the following eligible assets:

- (a) exposures to or guaranteed by central governments, ESCB central banks, public sector entities, regional governments or local authorities in the Union;
- (b) exposures to or guaranteed by third country central governments, third-country 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 third-country public sector entities, third-country regional governments or third-country local authorities that are risk weighted as exposures to institutions or central governments and central banks in accordance with Article 115(1) or (2), or Article 116(1), (2) or (4) respectively and that qualify for the credit quality step 1 as set out in this Chapter, and exposures within the meaning 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 the 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 to institutions in the Union 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;

(d) loans secured by:

(i) 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

(ii) senior units issued by French Fonds Communs de Titrisation or 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 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.

(e) residential loans fully guaranteed by an eligible protection provider referred to in Article 201 qualifying for the credit quality step 2 or above as set out in this Chapter, where the portion of each of the loans that is used to meet the requirement set out in this paragraph for collateralisation of the covered bond does not represent more than 80 % of the value of the corresponding residential property located in France, and where a loan-to-income ratio respects at most 33 % when the loan has been granted. There shall be no mortgage liens on the residential property when the loan is granted, and for the loans granted from 1 January 2014 the borrower shall be contractually committed not to grant such liens without the consent of the credit institution that granted the loan. The loan-to-income ratio represents the share of the gross income of the borrower that covers the reimbursement of the loan, including the interests. The protection provider shall be either a financial institution authorised and supervised by the competent authorities and subject to prudential requirements comparable to those applied to institutions in terms of robustness or an institution or an insurance undertaking. It shall establish a mutual guarantee fund or equivalent protection for insurance undertakings to absorb credit risk losses, whose calibration shall be periodically reviewed by the competent authorities. Both the credit institution and the protection provider shall carry out a creditworthiness assessment of the borrower;

(f) loans secured by:

(i) 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

(ii) senior units issued by French Fonds Communs de Titrisation or 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;

(g) loans secured by maritime liens on ships up to the difference between 60 % of the value of the pledged ship and the value of any prior maritime liens.

For the purposes of points (c), (d)(ii) and (f)(ii) of the first subparagraph, 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 limits referred to in those points.

The competent authorities may, after consulting EBA, partly waive the application of point (c) of the first subparagraph 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 that point.

2. The situations referred to in points (a) to (f) of paragraph 1 shall also include collateral that is exclusively restricted by legislation to the protection of the bond-holders against losses.

3. Institutions shall for immovable property collateralising covered bonds meet the requirements set out in Article 208 and the valuation rules set out in Article 229(1).

4. 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 136.

Table 6a

Credit quality step	1	2	3	4	5	6
Risk weight	10 %	20 %	20 %	50 %	50 %	100 %

5. 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 %.

6. Covered bonds issued before 31 December 2007 are not subject to the requirements of paragraphs 1 and 3. They are eligible for the preferential treatment under paragraphs 4 and 5 until their maturity.

7. Exposures in the form of covered bonds are eligible for preferential treatment, provided that the institution investing in the covered bonds can demonstrate to the competent authorities that:

- (a) it receives portfolio information at least on:
  - (i) the value of the cover pool and outstanding covered bonds;
  - (ii) the geographical distribution and type of cover assets, loan size, interest rate and currency risks;
  - (iii) the maturity structure of cover assets and covered bonds; and
  - (iv) the percentage of loans more than ninety days past due;
- (b) the issuer makes the information referred to in point (a) available to the institution at least semi annually.

### Article 130

#### Items representing securitisation positions

Risk weighted exposure amounts for securitisation positions shall be determined in accordance with Chapter 5.

### Article 131

#### 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 136.

Table 7

Credit Step	Quality	1	2	3	4	5	6
Risk weight		20 %	50 %	100 %	150 %	150 %	150 %

### Article 132

#### Exposures in the form of units or shares in CIUs

1. Exposures in the form of units or shares in 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 136.

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 in accordance with 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 law;
  - (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 464(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 2015, 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 that treatment before 1 January 2014.

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 133

##### Equity exposures

1. The following exposures shall be considered equity exposures:

- (a) non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;
- (b) debt exposures and other securities, partnerships, derivatives, or other vehicles, the economic substance of which is similar to the exposures specified in point (a).

2. Equity exposures shall be assigned a risk weight of 100 %, unless they are required to be deducted in accordance with Part Two, assigned a 250 % risk weight in accordance with Article 48(4), assigned a 1 250 % risk weight in accordance with Article 89(3) or treated as high risk items in accordance with Article 128.

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 48(4) or treated as high risk items in accordance with Article 128.

#### Article 134

##### Other items

1. Tangible assets within the meaning of Article 4(10) of Directive 86/635/EEC shall be assigned a risk weight of 100 %.



2. Prepayments and accrued income for which an institution is unable to determine the counterparty in accordance with Directive 86/635/EEC, shall be assigned a risk weight of 100 %.

3. Cash items in the process of collection shall be assigned a 20 % risk weight. Cash in hand and equivalent cash items shall be assigned a 0 % risk weight.

4. Gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities shall be assigned a 0 % risk weight.

5. In the case of asset sale and repurchase agreements and outright forward purchases, the risk weight shall be that assigned to the assets in question and not to the counterparties to the transactions.

6. Where an institution provides credit protection for a number of exposures under terms that the nth default among the exposures shall trigger payment and that this credit event shall terminate the contract, and where the product has an external credit assessment from an 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 1 250 % 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 201 regarding the eligibility of protection providers as well as the requirements for recognising other types of guarantees provided in Articles 213 to 215, 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 112. When the exposure is a residual value of leased assets, the risk weighted exposure amounts shall be calculated as follows:  $1/t * 100 \% * \text{residual value}$ , where t is the greater of 1 and the nearest number of whole years of the lease remaining.

### Section 3

## Recognition and mapping of credit risk assessment

### Sub-Section 1

#### Recognition of ECAIs

##### Article 135

#### 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. EBA shall publish the list of ECAIs in accordance with Article 2(4) and Article 18(3) of Regulation (EC) No 1060/2009 on its website.

### Sub-Section 2

#### Mapping of ECAI's credit assessments

##### Article 136

#### Mapping of ECAI's credit assessments

1. EBA, EIOPA and ESMA shall, through the Joint Committee, develop draft implementing technical 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.

EBA, EIOPA and ESMA shall submit those draft implementing technical standards to the Commission by 1 July 2014 and shall submit revised draft implementing 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 Article 15 of Regulation (EU) No 1093/2010, of Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 respectively.

2. When determining the mapping of credit assessments, EBA, EIOPA and ESMA shall comply with the following requirements:

(a) in order to differentiate between the relative degrees of risk expressed by each credit assessment, EBA, EIOPA and ESMA shall consider quantitative factors such as the long-term default rate associated with all items assigned the same credit assessment. For recently established ECAIs and for those that have compiled only a short record of default data, EBA, EIOPA and ESMA shall ask the ECAI what it believes to be the long-term default rate associated with all items assigned the same credit assessment;

- (b) in order to differentiate between the relative degrees of risk expressed by each credit assessment, EBA, EIOPA and ESMA shall consider qualitative factors such as the pool of issuers that the ECAI covers, the range of credit assessments that the ECAI assigns, each credit assessment meaning and the ECAI's definition of default;
- (c) EBA, EIOPA and ESMA 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, EBA, EIOPA and ESMA shall assign a higher credit quality step in the credit quality assessment scale to the ECAI credit assessment;
- (e) where EBA, EIOPA and ESMA have increased the associated risk weight for a specific credit assessment of a particular ECAI, and where default rates experienced for that ECAI's credit assessment are no longer materially and systematically higher than the benchmark, EBA, EIOPA and ESMA may restore the original credit quality step in the credit quality assessment scale for the ECAI credit assessment.

3. EBA, EIOPA and ESMA shall develop draft implementing technical standards to specify the quantitative factors referred to in point (a), the qualitative factors referred to in point (b) and the benchmark referred to in point (c) of paragraph 2.

EBA, EIOPA and ESMA shall submit those draft implementing technical standards to the Commission by 1 July 2014.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1093/2010, of Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 respectively.

#### Sub-Section 3

### Use of credit assessments by Export Credit Agencies

#### Article 137

#### Use of credit assessments by Export Credit Agencies

1. For the purpose of Article 114, 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 shall 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 %

#### Section 4

### Use of the ecai credit assessments for the determination of risk weights

#### Article 138

#### 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 shall 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 139

##### 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. Paragraphs 1 and 2 are not to prevent the application of Article 129.

4. Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

#### Article 140

##### 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 141

##### 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 142

##### 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) 'large financial sector entity' means any financial sector entity, other than those referred to in point (27)(j) of Article 4(1), which meets the following conditions:
- (a) its total assets, calculated on an individual or consolidated basis, are greater than or equal to a EUR 70 billion threshold, using the most recent audited financial statement or consolidated financial statement in order to determine asset size; and
- (b) it is, or one of its subsidiaries is, subject to prudential regulation in the Union or to the laws of a third country which applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union;
- (5) 'unregulated financial entity' means any other entity that is not a regulated financial sector entity but performs, as its main business, one or more of the activities listed in Annex I to Directive 2013/36/EU or listed in Annex I to Directive 2004/39/EC;
- (6) '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 probability of default (PD) are derived;
- (7) '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 LGD are derived;
- (8) '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)(b) of paragraph 1 of this Article, the Commission may adopt, by way of implementing acts, and subject to the examination procedure referred to in Article 464(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 2015, 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 2014.

#### Article 143

##### 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. Prior permission to the use the IRB Approach, including own estimates of 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 shall obtain the prior 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

*Article 144***Competent authorities' assessment of an application to use an IRB Approach**

1. The competent authority shall grant permission pursuant to Article 143 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 are 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 99;

- (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 draft 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 subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

*Article 145***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 146

#### 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 147

#### 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 Articles 115 and 116;

- (b) exposures to multilateral development banks referred to in Article 117(2);
- (c) exposures to International Organisations which attract a risk weight of 0 % under Article 118.

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 in accordance with Article 115(2) and (4);
- (b) exposures to Public Sector Entities which are not treated as exposures to central governments in accordance with Article 116(4);
- (c) exposures to multilateral development banks which are not assigned a 0 % risk weight under Article 117; and
- (d) exposures to financial institutions which are treated as exposures to institutions in accordance with Article 119(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) exposures to one or more natural persons;
  - (ii) exposures to an SME, 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 subparagraph, 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 166(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 148

#### **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 150.

Subject to the prior permission of the competent authorities, implementation may be carried out sequentially across the different exposure classes, referred to in Article 147, 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 147(5), implementation may be carried out sequentially across the categories of exposures to which the different correlations in Article 154 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 the IRB Approach only after 1 January 2013 or have until that 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 point (e) of Article 147(2), except where that institution is permitted to apply the Standardised Approach for equity exposures pursuant to Article 150 and for the other non credit-obligation assets exposure class laid down in point (g) of Article 147(2).

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

#### Article 149

##### 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 151(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 151(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 151(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 148 and the permission for permanent partial use referred to in Article 150.

#### Article 150

##### 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 Article 147(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 147(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, 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 114(2), (4) or (5);
- (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 113(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 119(4) meeting the conditions specified therein;
- (j) State and State-reinsured guarantees referred to in Article 215(2).

The competent authorities shall permit the application of Standardised Approach for equity exposures referred to in points (g) and (h) of the first subparagraph which have been permitted for that treatment in other Member States. EBA shall publish on its website and regularly update a list with the exposures referred to in those points (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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

4. EBA shall issue guidelines on the application of point (d) of paragraph 1 in 2018, recommending limits in terms of a percentage of total balance sheet and/or risk weighted assets to be calculated in accordance with the Standardised Approach.

Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.

## Section 2

### Calculation of risk weighted exposure amounts

#### Sub-Section 1

#### Treatment by type of exposure class

##### Article 151

#### 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 147(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 in accordance with Article 157. 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 Article 152 and Article 158(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 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 147(2) in accordance with Article 155. Institutions may use the approaches set out in Article 155(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 155(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 153(5).

6. For exposures belonging to the exposure classes referred to in points (a) to (d) of Article 147(2), institutions shall provide their own estimates of PDs in accordance with Article 143 and Section 6.

7. For exposures belonging to the exposure class referred to in point (d) of Article 147(2), institutions shall provide own estimates of LGDs and conversion factors in accordance with Article 143 and Section 6.

8. For exposures belonging to the exposure classes referred to in points (a) to (c) of Article 147(2), institutions shall apply the LGD values set out in Article 161(1), and the conversion factors set out in Article 166(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 147(2), the competent authority shall permit institutions to use own estimates of LGDs and conversion factors in accordance with Article 143 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 147(2) shall be calculated in accordance with Chapter 5.

#### Article 152

##### Treatment of exposures in the form of units or shares in CIUs

1. Where exposures in the form of units or shares in CIUs meet the criteria set out in Article 132(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 147(2)(e), institutions shall apply the simple risk-weight approach set out in Article 155(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 shall not be higher than 1 250 %;
- (ii) for all other exposures, the risk weight shall 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 150(2), Article 150(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 132(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 155(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 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 132(3)(a).

The correctness of the calculation shall be confirmed by an external auditor.



5. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities may permit institutions to use the Standardised Approach referred to in Article 150(1) under point (b) of paragraph 2 of this Article.

EBA shall submit those draft regulatory technical standards to the Commission by 30 June 2014.

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

#### Sub-Section 2

### Calculation of risk weighted exposure amounts for credit risk

#### Article 153

### 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

(iii) if  $0 < PD < 1$

$$RW = \left( LGD \cdot N \left( \frac{1}{\sqrt{1-R}} \cdot G(PD) + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right) - LGD \cdot PD \right) \cdot \frac{1 + (M-2,5) \cdot b}{1 - 1,5 \cdot b} \cdot 12,5 \cdot 1,06$$

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, the co-efficient of correlation of paragraph 1(iii) is multiplied by 1,25. For all exposures to unregulated financial entities, the coefficients of correlation set out in paragraph 1(iii) and paragraph 4, as relevant, are multiplied by 1,25.

3. The risk weighted exposure amount for each exposure which meets the requirements set out in Articles 202 and 217 may be adjusted according to the following formula:

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 161(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 ' $EL_{BE}$ ') shall be the institution's best estimate of expected loss for the defaulted exposure in accordance with Article 181(1)(h);

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

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 million  $\leq$  S  $\leq$  EUR 50 million. Reported sales of less than EUR 5 million shall be treated as if they were equivalent to EUR 5 million. For purchased receivables the total annual sales shall be the weighted average by individual exposures of the pool.

$$R = 0.12 \cdot \frac{1 - e^{-50 \cdot PD}}{1 - e^{-50}} + 0.24 \cdot \left( 1 - \frac{1 - e^{-50 \cdot PD}}{1 - e^{-50}} \right) - 0.04 \cdot \left( 1 - \frac{\min\{\max\{5, S\}, 50\} - 5}{45} \right)$$

Institutions shall substitute total assets of the consolidated group for total annual sales when total annual sales are not a meaningful indicator of firm size and total assets are a more meaningful indicator than total annual sales.

5. For specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet the requirements set out in Section 6, the institution shall assign risk weights to these exposures according to Table 1, as follows:

Table 1

Remaining Maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2,5 years	50 %	70 %	115 %	250 %	0 %
Equal or more than 2,5 years	70 %	90 %	115 %	250 %	0 %

In assigning risk weights to specialised lending exposures institutions shall take into account the following factors: financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public private partnership income stream, and security package.

6. For their purchased corporate receivables institutions shall comply with the requirements set out in Article 184. For purchased corporate receivables that comply in addition with the conditions set out in Article 154(5), and where it would be unduly burdensome for an institution to use the risk quantification standards for corporate exposures as set out in Section 6 for these receivables, the risk quantification standards for retail exposures as set out in Section 6 may be used.

7. For purchased corporate receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for default losses, dilution losses, or both, may be treated as first-loss positions under the IRB securitisation framework.

8. Where an institution provides credit protection for a number of exposures under terms that the nth default among the exposures shall trigger payment and that this credit event shall terminate the contract, if the product has an external credit assessment from an 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 1 250 % 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 how institutions shall take into account the factors referred to the second subparagraph of paragraph 5 when assigning risk weights to specialised lending exposures.

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

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

#### Article 154

##### 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:

$$RW = \left( LGD \cdot N \left( \frac{1}{\sqrt{1-R}} \cdot G(PD) + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right) - LGD \cdot PD \right) \cdot 12,5 \cdot 1,06$$

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 an SME as referred to in Article 147(5) which meets the requirements set out in Articles 202 and 217 may be calculated in accordance with Article 153(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 in accordance with 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

(i) 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 in accordance with Article 181(1)(h);

(ii) if  $0 < PD < 1$ , i.e., for any possible value for PD other than under (i)

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 100 000 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 as 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 184 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 155

##### **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 48, in accordance with 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 formula:

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

where:

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.

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 162(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 153(1). If institutions do not have sufficient information to use the definition of default set out in Article 178, 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 4. 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 five 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 165(1) and the corresponding LGD values set out in Article 165(2).

Institutions may recognise unfunded credit protection obtained on an equity position.

#### Article 156

#### **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 157

#### **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 according to the formula set out in Article 153(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 158

#### **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 are used for the calculation of risk-weighted exposure amounts in accordance with Article 151.

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 147(2) shall be zero.

4. The expected loss amounts for exposures in the form of shares or units of a CIU referred to in Article 152 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:

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

Expected loss amount = EL [multiplied by] 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 in accordance with Article 181(1)(h).

For exposures subject to the treatment set out in Article 153(3), EL shall be 0 %.

6. The EL values for specialised lending exposures where institutions use the methods set out in Article 153(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:

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

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:

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

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

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:

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

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

#### Article 159

#### Treatment of expected loss amounts

Institutions shall subtract the expected loss amounts calculated in accordance with Article 158 (5), (6) and (10) from the general and specific credit risk adjustments and additional value adjustments in accordance with Articles 34 and 110 and other own funds reductions related to these exposures. Discounts on balance sheet exposures purchased when in default in accordance with Article 166(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 160

#### 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 143 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 the 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 201(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 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;

(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 ECAs 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.

5. Institutions using own LGD estimates may recognise unfunded credit protection by adjusting PDs subject to Article 161(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 143 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 201(1)(g), the seller of the purchased receivables is eligible provided that the conditions set out in paragraph 4 are met.

7. By way of derogation from Article 201(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 143 to use own LGD estimates for dilution risk of purchased corporate receivables, may recognise unfunded credit protection by adjusting PDs subject to Article 161(3).

#### Article 161

##### 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 eligible for the treatment set out in Article 129(4) or (5) 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 143 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 143, 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 153(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 162

##### Maturity

1. Institutions that have not received permission to use own LGDs and own conversion factors 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 143, 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 143 shall calculate M for each of these exposures as set out in points (a) to (e) of this paragraph and subject to paragraphs 3 to 5 of this Article. M shall be no greater than five years except in the cases specified in Article 384(1) where M as specified there shall be used:

(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 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 five 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 143 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 paragraph 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:

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

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 153(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 383 contains effects of rating migrations;
- (j) for the purposes of Article 153(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 connected to the exchange of goods or services with a residual maturity of up to one year as referred to in point (80) of Article 4(1);
- (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 1 000 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 163

#### Probability of default (PD)

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 164(2). For dilution risk, in addition to the protection providers referred to in Article 201(1)(g), the seller of the purchased receivables is eligible if the conditions set out in Article 160(4) are met.

#### Article 164

##### 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 143. 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 183(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 154(2), the LGD of a comparable direct exposure to the protection provider referred to in Article 153(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 101 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 of this Article 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.

6. EBA shall develop draft 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 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

7. 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 165

##### 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 155(2);
- (d) 1,25 % for all other equity exposures including other short positions as set out in Article 155(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 five years.

## Section 5

### Exposure value

#### Article 166

#### **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 or 6.

3. In order to calculate the exposure value for on-balance sheet netting of loans and deposits, institutions shall apply 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 201 regarding the eligibility of protection providers as well as the requirements for recognising other types of guarantees provided in Article 213, the payment obligation may be taken into account as unfunded credit protection in accordance with Chapter 4.

5. In the case of any contract 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 determined in accordance with 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 24. Where the Financial Collateral Comprehensive Method as set out under Article 223 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 220(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 151(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 paragraphs 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 167*

##### **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 168*

##### **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 169*

##### **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 170*

##### **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 153(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 171

##### 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 172

##### 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 155(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 143, 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 153(5) for assigning risk weights for specialised lending exposures shall assign each of these exposures to a grade in accordance with Article 170(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 173

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

#### Article 174

##### 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 175

##### 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 176

##### 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 155(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 161(1) and realised conversion factors to the values as set out in Article 166(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 177

##### 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 153(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.

#### Sub-Section 2

##### Risk quantification

#### Article 178

##### 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. Competent authorities may replace the 90 days with 180 days for exposures secured by residential or SME commercial real estate in the retail exposure class, as well as exposures to public sector entities). The 180 days shall not apply for the purposes of Article 127.

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

2. 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-aging 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.

3. For the purpose of point (a) of paragraph 1, elements to be taken as indications of unlikeliness 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.

4. 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.

5. 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. Where the definition of default is subsequently triggered, another default would be deemed to have occurred.

6. 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 2(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 subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

7. 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 179

##### 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 Article 180(1)(h) and (2)(e), Article 181(1)(j) and (2), and Article 182(2) and (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 178 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 180

##### 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 155(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 181(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 178. 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 174;
- (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 143 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.
- 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 181(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).

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

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 143.

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

#### Article 181

##### 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 in accordance with 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 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### Article 182

##### 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. By way of derogation from point (a) of paragraph 1, 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 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### Article 183

##### 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 171, 172 and 173 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 171, 172 and 173.

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 216(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 201(1)(g) if the institution has received permission to apply the Standardised Approach for exposures to such entities pursuant to Articles 148 and 150. In this case the requirements of Chapter 4 shall apply.

5. For retail guarantees, the requirements set out in paragraphs 1, 2 and 3 shall 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 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### Article 184

##### 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 185

#### 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 186***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 187***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 188

##### 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 189

##### 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.

#### Article 190

##### 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 in accordance with Article 179(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 191

##### 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 192

##### 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 CIU' means a CIU in the shares or units of which another CIU has invested.

#### Article 193

##### 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 applicable, 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 amend 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 194

#### 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. Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the assets relied upon for protection meet both of the following conditions:

- (a) they are included in the list of eligible assets set out in Articles 197 to 200, as applicable;
- (b) they are sufficiently liquid and their value over time sufficiently stable 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.

4. Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where 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 Article 201 or 202, 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 203 and 204(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 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 fact that credit risk mitigation has been taken into account for the purposes of calculating risk-weighted exposure amounts and, where applicable, 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 lending 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. EBA shall develop draft regulatory technical standards to specify what constitutes sufficiently liquid assets and when asset values can be considered as sufficiently stable for the purpose of paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 30 September 2014.

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

## Section 2

### Eligible forms of credit risk mitigation

#### Sub-Section 1

#### Funded credit protection

##### Article 195

#### 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 196, eligibility is limited to reciprocal cash balances between the institution and the counterparty. Institutions may amend 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 196

#### 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 223 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 299, 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 197 and 198.

#### Article 197

#### 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 115(2);
- (b) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with Article 116(4);
- (c) debt securities issued by multilateral development banks to which a 0 % risk weight is assigned under Article 117(2);
- (d) debt securities issued by international organisations which are assigned a 0 % risk weight under Article 118.

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 in accordance with Article 116(1) and (2);
- (c) debt securities issued by multilateral development banks other than those to which a 0 % risk weight is assigned under Article 117(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 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 point (c);

- (e) the market liquidity of the instrument is sufficient for these purposes.

5. Institutions may use units or shares in CIUs as eligible collateral where all the following conditions are satisfied:

- (a) the units or shares have a daily public price quote;
- (b) the CIUs are limited to investing in instruments that are eligible for recognition under paragraphs 1 and 2;
- (c) the CIUs meet the conditions laid down in Article 132(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 CIU 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 CIU ('the original CIU') or any of its underlying CIUs 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 CIUs have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

Where any underlying CIUs has underlying CIUs 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 ECAs, institutions shall apply the less favourable assessment. Where a security has more than two credit assessments by ECAs, 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.

8. ESMA shall develop draft implementing technical standards to specify the following:

- (a) the main indices referred to in point (f) of paragraph 1 of this Article, in point (a) of Article 198(1), in Article 224(1) and (4), and in point (e) of Article 299(2);
- (b) the recognised exchanges referred to in point (a) of paragraph 4 of this Article, in point (a) of Article 198(1), in Article 224(1) and (4), in point (e) of Article 299(2), in point (k) of Article 400(2), in point (e) of Article 416(3), in point (c) of Article 428(1), and in point 12 of Annex III in accordance with the conditions laid down in point (72) of Article 4(1).

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 Article 15 of Regulation (EU) No 1095/2010.

#### Article 198

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

1. In addition to the collateral established in Article 197, where an institution uses the Financial Collateral Comprehensive Method set out in Article 223, 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 CIUs where both the following conditions are met:

- (i) the units or shares have a daily public price quote;
- (ii) the CIU is limited to investing in instruments that are eligible for recognition under Article 197(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 CIU of derivative instruments to hedge permitted investments shall not prevent units or shares in that undertaking from being eligible as collateral.

2. Where the CIU or any underlying CIU are not limited to investing in instruments that are eligible for recognition under Article 197(1) and (4) and the items mentioned in point (a) of paragraph 1 of this Article, 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 CIUs 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 199

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

1. In addition to the collateral referred to in Articles 197 and 198, 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, 3 and 4;
- (b) receivables in accordance with paragraph 5;
- (c) other physical collateral in accordance with paragraphs 6 and 8;
- (d) leasing in accordance with paragraph 7.



2. Unless otherwise specified under Article 124(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. 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 124(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 set out in that subparagraph until both conditions are satisfied in a subsequent year.

4. 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 set out in that subparagraph until both conditions are satisfied in a subsequent year.

5. 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.

6. Competent authorities shall permit an institution to use as eligible collateral physical collateral of a type other than those indicated in paragraphs 2, 3 and 4 where all the following conditions are met:

- (a) there are liquid markets, evidenced by frequent transactions taking into account the asset type, 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 210.

7. Subject to the provisions of Article 230(2), where the requirements set out in Article 211 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.

8. 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 6 are met.

#### Article 200

##### 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 201

##### 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 117 is assigned;

(e) public sector entities, claims on which are treated in accordance with Article 116;

(f) institutions, and financial institutions for which exposures to the financial institution are treated as exposures to institutions in accordance with Article 119(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 an 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.

Competent authorities shall publish and maintain the list of those financial institutions that are eligible providers of unfunded credit protection under point (f) of paragraph 1, or the guiding criteria for identifying such 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 117 of Directive 2013/36/EU.

#### Article 202

##### Eligibility of protection providers under the IRB Approach which qualify for the treatment set out in Article 153(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 153(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 203

##### Eligibility of guarantees as unfunded credit protection

Institutions may use guarantees as eligible unfunded credit protection.

#### Sub-Section 3

##### Types of derivatives

#### Article 204

##### 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 205

##### Requirements for on-balance sheet netting agreements other than master netting agreements referred to in Article 206

On-balance sheet netting agreements other than master netting agreements referred to in Article 206 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 206

##### 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 207(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 207

##### 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. Where the value of the collateral is reduced significantly, this shall not alone imply a significant deterioration of the credit quality of the obligor. Where the credit quality of the obligor becomes 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 129 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 208

##### 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 certainty 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 209

##### 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 including the right to the proceeds from the sale of 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.
- (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.

#### Article 210

##### 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 209(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:

- (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 211

##### 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 Article 208 or 210, as applicable, 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 212***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 232(1), where all 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;
- (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.

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

1. Subject to Article 214(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 a deterioration in the 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 134(7) and 166(4);
  - (iv) could allow the maturity of the credit protection to be reduced by the protection provider;
- (d) the credit protection contract 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.

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

#### Article 214

##### **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 213 and 215(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 set out 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 116(4);
- (d) a multilateral development bank or an international organisation, to which a 0 % risk weight is assigned under or by virtue of Articles 117(2) and 118 respectively;

(e) a public sector entity, claims on which are treated in accordance with Article 116(1) and (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 215

##### **Additional requirements for guarantees**

1. Guarantees shall qualify as eligible unfunded credit protection where all the conditions in Article 213 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 213(1)(c)(iii) and in the first subparagraph of this point 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 214(2), the requirements in point (a) of paragraph 1 of this Article 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 216

##### Additional requirements for credit derivatives

1. Credit derivative shall qualify as eligible unfunded credit protection where all the conditions in Article 213 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 233(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 217

##### Requirements to qualify for the treatment set out in Article 153(3)

1. To be eligible for the treatment set out in Article 153(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 referred to in Article 147, 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 in accordance with Article 147;
  - (iii) an exposure to an SME, classified as a retail exposure in accordance with Article 147(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 213, 215 and 216, as applicable;
- (e) the risk weight that is associated with the exposure prior to the application of the treatment set out in Article 153(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 153(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 153(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 218

#### 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, the institution may consider the condition in point (c) of Article 194(6) to be met.

##### Article 219

#### On-balance sheet netting

Loans to 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 220

#### 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 223 to 226 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:
- (a) 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) 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) 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) 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 113 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 224 and 225, as applicable.

## Article 221

**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 220.

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 292(8) and (9) and in Article 294.

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 285(2), (3) and (4), 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 285(5).

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 113 under the Standardised Approach or Chapter 3 under the IRB Approach.

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

- (a) what constitutes an immaterial portfolio for the purpose of paragraph 3;
- (b) the criteria for determining whether an internal model is sound and implemented with integrity for the purpose of paragraphs 4 and 5 and master netting agreements.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2015.

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

#### Article 222

##### 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 148(1) and 150(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 207(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 111(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 227. 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 114, 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 115;
- (b) debt securities issued by multilateral development banks to which a 0 % risk weight is assigned under or by virtue of Article 117(2);
- (c) debt securities issued by international organisations which are assigned a 0 % risk weight under Article 118;
- (d) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with Article 116(4).

#### Article 223

#### 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 224 to 227, 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 224 to 227.

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 224 and 227;

$H_{fx}$  = the volatility adjustment appropriate to currency mismatch, as calculated under Articles 224 and 227.

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 220 and 221 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 applicable, where the exposure was not collateralised;

$H_E$  = the volatility adjustment appropriate to the exposure, as calculated under Articles 224 and 227.

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 111(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 166(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 224 or the Own Estimates Approach referred to in Article 225.

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 224

#### 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 Article 197(1)(b)			Volatility adjustments for debt securities issued by entities described in Article 197(1) (c) and (d)			Volatility adjustments for securitisation positions and meeting the criteria in Article 197(1) (h)		
		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

Table 2

Credit quality step with which the credit assessment of a short term debt security is associated	Volatility adjustments for debt securities issued by entities described in Article 197(1)(b) with short-term credit assessments			Volatility adjustments for debt securities issued by entities described in Article 197(1) (c) and (d) with short-term credit assessments			Volatility adjustments for securitisation positions and meeting the criteria in Article 197(1)(h)		
	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	0,707	0,5	0,354	1,414	1	0,707	2,829	2	1,414
2-3	1,414	1	0,707	2,828	2	1,414	5,657	4	2,828

Table 3

## Other collateral or exposure types

	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
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 Article 285(2), (3) and (4), 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 197(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 CIUs 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 197(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 225***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 an 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 an 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 226

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

The volatility adjustments set out in Article 224 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 225, 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<sub>M</sub> = the volatility adjustment where there is daily revaluation;

N<sub>R</sub> = the actual number of business days between revaluations;

T<sub>M</sub> = the liquidation period for the type of transaction in question.

## Article 227

**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 224 or the Own Estimates Approach under Article 225 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 224 to 226, apply a 0 % volatility adjustment. Institutions using the internal models approach set out in Article 221 shall not use the treatment set out 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 197(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 197(1)(b) exposures to which are assigned a 0 % risk weight under Chapter 2;

(b) institutions;

(c) other financial undertakings within the meaning of points (25)(b) and (d) of Article 13 of Directive 2009/138/EC 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 CIUs that are subject to capital or leverage requirements;

(e) regulated pension funds;

(f) recognised clearing organisations.

#### Article 228

##### 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 223(5) as the exposure value for the purposes of Article 113. 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 111(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.

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

where:

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

E = the exposure value in accordance with Article 223(3);

E\* = the fully adjusted exposure value in accordance with Article 223(5).

#### Article 229

##### 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 at 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 at 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 208(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 230

##### 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 Article 166(8) to (10) by using a conversion factor or percentage of 100 % rather than the conversion factors or percentages indicated in those paragraphs.

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 exposure	LGD* for subordinated exposures	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 set out in paragraphs 1 and 2, and subject to Article 124(2), institutions may assign a 50 % risk weight to the part of the exposure that is, within the limits set out in Article 125(2)(d) and Article 126(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 199(4) are met.

#### Article 231

##### 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 223(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 applicable.

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 232

##### Other funded credit protection

1. Where the conditions set out in Article 212(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 212(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 the event of a currency mismatch, institutions shall reduce the current surrender value in accordance with Article 233(3), the value of the credit protection being the current surrender value of the life insurance policy.

3. For the 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 undertaking providing the life insurance is assigned a risk weight of 20 %;
- (b) a risk weight of 35 %, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 50 %;
- (c) a risk weight of 70 %, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 100 %;
- (d) a risk weight of 150 %, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 150 %.

4. Institutions may treat instruments repurchased on request that are eligible under Article 200(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 in Article 197(4).

#### Sub-Section 2

##### Unfunded credit protection

#### Article 233

##### 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 224 and 225 respectively. Institutions shall scale up the volatility adjustments in accordance with Article 226.

#### Article 234

### Calculating risk-weighted exposure amounts and expected loss amounts in the event 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 235

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

1. For the purposes of Article 113(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 in accordance with Article 111; 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 111(1);

$G_A$  = the amount of credit risk protection as calculated under Article 233(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 set out in Article 114(4) and (7) 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 236

### 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 233(3) further adjusted for any maturity mismatch as laid down in Section 5. E is the exposure value determined in accordance with Section 5 of Chapter 3. For this purpose, institutions shall calculate the exposure value of the items listed in Article 166(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 237

##### 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 162(3).

#### Article 238

##### Maturity of credit protection

1. Subject to a maximum of five 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 239

##### 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 223(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 238, 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 238, or five 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 223(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 238, 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 238, or five years, whichever is lower;

$t^*$  = 0,25.

Institutions shall use  $G_A$  as the value of the protection for the purposes of Articles 233 to 236.

#### Section 6

### Basket CRM techniques

#### Article 240

#### 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 amend 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 that 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 set out in this Article applies only where the exposure value is less than or equal to the value of the credit protection.

#### Article 241

### Nth-to-default credit derivatives

Where the nth 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 applicable, 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 amend the calculation of the risk-weighted exposure amount and, as applicable, 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 nth lowest amount as specified in points (a) and (b) of Article 240.

The treatment set 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 204(2) and Article 216(1)(d).

#### CHAPTER 5

### Securitisation

#### Section 1

### Definitions

#### Article 242

### 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 261;
- (6) 'supervisory formula method' means the method of calculating risk-weighted exposure amounts for securitisation positions in accordance with Article 262;
- (7) 'unrated position' means a securitisation position which does not have an eligible credit assessment by an ECAI as referred to in Section 4;
- (8) 'rated position' means a securitisation position which has an eligible credit assessment by an ECAI as referred to 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;
- (13) 'revolving securitisation' means a securitisation where the securitisation structure itself revolves by exposures being added to or removed from the pool of exposures irrespective of whether the exposures revolve or not;
- (14) '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;

- (15) '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 243

##### 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 1 250 % 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 36(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 1 250 % 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 1 250 % 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 authorities 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 1 250 % 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. EBA shall review Member States' implementation of those guidelines and provide advice to the Commission by 31 December 2017 on whether a binding technical standard is required.

## Article 244

**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 249, 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 1 250 % 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 36(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 1 250 % 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 1 250 % 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 1 250 % 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 247(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. 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. EBA shall review Member States' implementation of those guidelines and provide advice to the Commission by 31 December 2017 on whether a binding technical standard is required.

### Section 3

## Calculation of the risk weighted exposure amounts

### Sub-Section 1

#### Principles

##### Article 245

#### 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 249 and 250.

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 36(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 92(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 246, 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 407.

##### Article 246

#### 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 treated in accordance with Article 110 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 treated in accordance with Article 110 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 268(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 that treatment.

#### Article 247

#### 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 Chapter 4.

3. By way of derogation from paragraph 2, the eligible providers of unfunded credit protection listed in points (a) to (h) of Article 201(1) except for qualifying central counterparties 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 136 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 136.

4. By way of 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 248

#### Implicit support

1. A sponsor institution, or an originator institution which in respect of a securitisation has made use of Article 245(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, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue 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 249

##### General treatment

In calculating risk-weighted exposure amounts for the securitised exposures, where the conditions in Article 244 are met, the originator institution of a synthetic securitisation shall, subject to Article 250, 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 250, 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 247, in which case the risk-weight to be applied to that position may be amended in accordance with Chapter 4, subject to the requirements laid down in this Chapter.

#### Article 250

### Treatment of maturity mismatches in synthetic securitisations

For the purposes of calculating risk-weighted exposure amounts in accordance with Article 249, any maturity mismatch between the credit protection which constitutes a tranche and 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 subject to a maximum of five years. 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 1 250 %. 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 92(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 249 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

## Article 253

**Calculation of risk-weighted exposure amounts under the Standardised Approach**

## Article 251

**Risk-weights**

Subject to Article 252, 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 %	1 250 %
Re-securitisation positions	40 %	100 %	225 %	650 %	1 250 %

Subject to Articles 252 to 255, the risk-weighted exposure amount of an unrated securitisation position shall be calculated by applying a risk weight of 1 250 %.

## Article 252

**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 128 amongst the securitised exposures.

**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 1 250 % 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 1 250 % to the position.

## Article 254

**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 255 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 255

**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 256

#### **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, in accordance with 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 in accordance with 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 32(1), shall be treated outside the maximum amount indicated in the preceding subparagraph.

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
Three 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) that treatment is more appropriate because the institution can establish a quantitative measure equivalent, in relation to the quantitative value triggering early amortisation, to the trapping level of excess spread;

(b) that 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 257*

### **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 amended in accordance with Chapter 4.

#### *Article 258*

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

Where a securitisation position is assigned a 1 250 % risk weight, institutions may in accordance with Article 36(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 257.

Where an originator institution makes use of this alternative, it may subtract 12.5 times the amount deducted in accordance with Article 36(1)(k) from the amount specified in Article 252 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 259*

### **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 261 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 262 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 prior permission of the competent authorities, which shall only be granted where the institution fulfils the condition provided in the first sentence of this point;

(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 1 250 % shall be assigned to securitisation positions which are unrated;

(e) notwithstanding point (d), and subject to the prior permission by the competent authorities, an institution may calculate the risk weight for an unrated position in an ABCP programme in accordance with Article 253 or 254, if the unrated position is not in commercial paper and falls within the scope of application of an Internal Assessment Approach for which permission is being sought. The aggregated exposure values treated by this exception shall not be material and in any case less than 10 % of the aggregate exposure values treated by the institution under the Internal Assessment Approach. The institution shall stop making use of this when the permission for the relevant Internal Assessment Approach has been refused.

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 shall 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) of 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 260

##### Maximum risk-weighted exposure amounts

An originator institution, a sponsor institution, or other institutions which can calculate KIRB 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 92(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 261

##### 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 %

Credit Quality Step		Securitisation Positions			Re-securitisation Positions	
Credit assessments other than short term	Short term credit assessments	A	B	C	D	E
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		1 250 %				

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  $EAD_i$  represents the sum of the exposure values of all exposures to the  $i^{\text{th}}$  obligor. If the portfolio share associated with the largest exposure,  $C_1$ , is available, the institution may compute  $N$  as  $1/C_1$ .

2. Credit risk mitigation on securitisation positions may be recognised in accordance with Article 264(1) and (4), subject to the conditions in Article 247.

#### Article 262

#### 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:

$$S[x] = \begin{cases} K_{IRBR} + K[x] - K[K_{IRBR}] + \left( 1 - \exp\left(-\frac{x}{K_{IRBR}}\right) \right) \cdot \frac{d \cdot K_{IRBR}}{\omega}, & \text{when } x \leq K_{IRBR} \\ \left( 1 - \exp\left(-\frac{\omega \cdot (K_{IRBR} - x)}{K_{IRBR}}\right) \right) \cdot \frac{d \cdot K_{IRBR}}{\omega}, & \text{when } x > K_{IRBR} \end{cases}$$

where:

$$h = \left( 1 - \frac{K_{IRBR}}{ELGD} \right)^N$$

$$c = \frac{K_{IRBR}}{1 - h}$$

$$v = \frac{(ELGD - K_{IRBR}) \cdot K_{IRBR} + 0,25 \cdot (1 - ELGD) \cdot K_{IRBR}}{N}$$

$$f = \left( \frac{v + K_{IRBR}^2}{1 - h} - c^2 \right) + \frac{(1 - K_{IRBR}) \cdot K_{IRBR} - v}{(1 - h) \cdot \tau}$$

$$g = \frac{(1 - c) \cdot c}{f} - 1$$

$$a = g \cdot c$$

$$b = g \cdot (1 - c)$$

$$d = 1 - (1 - h) \cdot (1 - \text{Beta}[K_{IRBR}; a, b])$$

$$K[x] = (1 - h) \cdot ((1 - \text{Beta}[x; a, b]) \cdot x + \text{Beta}[x; a + 1, b] \cdot c)$$

$$\tau = 1\,000;$$

$$\omega = 20;$$

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 261. 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 not 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 EBA informed about the use institutions make of paragraph 2. 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 Article 264(2) to (4), subject to the conditions in Article 247.

#### Article 263

#### 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 255(2).

2. When it is not possible 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 liquidity facility that meets the conditions in Article 255(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 shall, in general, be deemed not to be possible 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 255(1). To determine the exposure value of the position a conversion factor of 100 % shall be applied.

#### Article 264

##### **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 amended in accordance with the provisions of Chapter 4 as they apply for the calculation of risk-weighted exposure amounts under Chapter 2.

2. In the 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 ( $GA$ ) 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  $GA$  by the effective risk weight.

3. In the 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 262 shall apply subject to the adjustment of  $T$  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 the 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 in accordance with Article 235 shall be determined as specified in Chapter 3.

#### Article 265

##### **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 in accordance with the methodology set out in Article 256 when it sells revolving exposures into a securitisation that contains an early amortisation provision.

2. By way of derogation from Article 256, 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 in accordance with 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 266

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

1. The risk-weighted exposure amount of a securitisation position to which a 1 250 % risk weight is assigned may be reduced by 12,5 times the amount of any specific credit risk adjustments treated in accordance with Article 110 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 159.

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 treated in accordance with Article 110 made by the institution in respect of the position.

3. As provided in Article 36(1)(k) in respect of a securitisation position in respect of which a 1 250 % 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 247 and 264;

(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 260 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 267

##### Use of Credit Assessments by ECAIs

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.

#### Article 268

##### Requirements to be met by the credit assessments of ECAIs

For the purposes of calculating risk-weighted exposure amounts in accordance with 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 in accordance with 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 269***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.

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 270***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 amending 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 July 2014.

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

*CHAPTER 6***Counterparty credit risk***Section 1***Definitions***Article 271***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.

*Article 272***Definitions**

For the purposes of this Chapter and of Title VI of this Part, the following definitions shall apply:

**General terms**

(1) 'counterparty credit risk' or '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 the greater of the expected exposure at that date or the effective expected exposure at any 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 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 273

#### 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 94 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 to 6 on a permanent basis but shall be permitted to use in combination methods set out in Sections 3 and 5 when one of the methods is used for the cases set out in Article 282(6).

2. Where permitted by the competent authorities in accordance with Article 283(1) and (2), 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) Articles 233 to 236;
- (b) in accordance with Article 153(3), or Article 183, where permission has been granted in accordance with Article 143.

The exposure value for CCR for those credit derivatives shall be zero, unless an institution applies the approach (ii) in point (h) of Article 299(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 that has been already excluded from own funds under Article 33(1)(c).

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.

For the methods set out in Sections 3 to 6, institutions shall treat transactions where specific wrong way risk has been identified in accordance with Article 291(2), (4), (5) and (6) as appropriate.

## Section 3

**Mark – to – market Method**

## Article 274

**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 361 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 275

**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 276

**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:

$$\text{Exposure value} = \beta \cdot \max \left\{ \text{CMV} - \text{CMC}, \sum_j \left| \sum_i \text{RPT}_{ij} - \sum_l \text{RPC}_{lj} \right| \cdot \text{CCRM}_j \right\}$$

where:

CMV = current market value of the portfolio of transactions within the netting set with a counterparty gross of collateral, where:

$$\text{CMV} = \sum_i \text{CMV}_i$$

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:

$$\text{CMC} = \sum_l \text{CMC}_l$$

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<sub>ij</sub> = risk position from transaction i with respect to hedging set j;

RPC<sub>lj</sub> = risk position from collateral l with respect to hedging set j;

CCRM<sub>j</sub> = CCR Multiplier set out in Table 5 with respect to hedging set j;

β = 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 197, Article 198 and Article 299(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 277

##### 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, 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 278

##### 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 280(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.

#### Article 279

##### Treatment of Collateral

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 280

##### 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 276(2) as follows:

$$\left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right|$$

#### Article 281

##### 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 336, 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 year
	>1 ≤ 5 years	> 5 years
	>1 ≤ 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 282

##### 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 336 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 CCRMs conservatively, or require the institution to use 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 283

#### 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 273(2)(a);

(b) transactions in Article 273(2)(b), (c) and (d);

(c) transactions in Article 273(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 first subparagraph, it may also use the IMM for the transactions in Article 273(2)(e).

Notwithstanding the third subparagraph of Article 273(1), 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 282(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 284

##### Exposure value

1. Where an institution is permitted, in accordance with Article 283(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 of the future dates on the basis of the joint changes in the market variables.

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 referred to in Articles 197 and 198 and points (c) and (d) of Article 299(2).

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 Article 291(4) and (5), institutions shall calculate the exposure value as the product of alpha (α) times Effective EPE, as follows:

$$\text{Exposure value} = \alpha \cdot \text{Effective EPE}$$

where:

α = 1.4, unless competent authorities require a higher α or permit institutions to use their own estimates in accordance with paragraph 9;

Effective EPE shall be calculated by estimating expected exposure (EE<sub>t</sub>) 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<sub>1</sub>, t<sub>2</sub>, t<sub>3</sub>, etc.

5. Effective EE shall be calculated recursively as:

$$\text{Effective EE}_{t_k} = \max \{ \text{Effective EE}_{t_{k-1}}, \text{EE}_{t_k} \}$$

where:

the current date is denoted as t<sub>0</sub>;

Effective EE<sub>t<sub>0</sub></sub> 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 Δt<sub>k</sub> = t<sub>k</sub> - t<sub>k-1</sub> 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 285

#### 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 284(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 5.

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.

3. Points (a) and (b) of paragraph 2 shall be subject to the following exceptions:

(a) 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;

(b) 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.

4. 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 paragraphs 2 and 3, the institution shall use a margin period of risk that is at least double the period specified in paragraphs 2 and 3 for that netting set for the subsequent two quarters.

5. For re-margining with a periodicity of N days, the margin period of risk shall be at least equal to the period specified in paragraphs 2 and 3, plus N days minus one day. That is:

$$\text{Margin Period of Risk} = F + N - 1$$

6. 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.

7. If an institution is not able to model collateral jointly with the exposure, it shall not recognise in its exposure value calcu-

lations 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.

8. 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 286

#### 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 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 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 287(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 287

##### Organisation structures for CCR 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 amendment 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 288

##### Review of CCR 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 287 and shall specifically address, as a minimum:

- (a) the adequacy of the documentation of the CCR management system and process required by Article 286;

- (b) the organisation of the CCR control unit required by Article 287(1)(a);

- (c) the organisation of the collateral management unit required by Article 287(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 293(1);

- (o) the compliance of the CCR control unit and collateral management unit with the relevant regulatory requirements.

#### Article 289

##### 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 283.

3. The model used to generate a distribution of exposures to CCR shall be part of the CCR management framework required by Article 286. 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 290

##### 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 81 of Directive 2013/36/EU.

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 291

##### 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 PD due to the nature of the transactions with the counterparty. An 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 issuer of the underlying of the OTC derivative or the underlying of the transactions referred to in points (b), (c) and (d) of Article 273(2)), 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 calculation of the exposure value shall be consistent with the assumption of a jump-to-default of those underlying obligations where the issuer is legally connected with the counterparty. For transactions referencing a basket of names or index, the jump-to-default of the respective underlying obligations where the issuer is legally connected with the counterparty, shall be applied, if material;

- (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 292

##### Integrity of the modelling process

1. An institution shall ensure the integrity of modelling process as set out in Article 284 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 291(1)(b) and exposures to General Wrong-Way risk arising as specified in Article 291(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 293

##### 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 287(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 288;

- (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 284(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 294

##### Validation requirements

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 283(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 Article 285(1)(b) 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 for which exposure is calculated using IMM in accordance to the Article 283;
- (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 295

**Recognition of contractual netting as risk-reducing**

Institutions may treat as risk reducing in accordance with Article 298 only the following types of contractual netting agreements where the netting agreement has been recognised by competent authorities in accordance with Article 296 and where the institution meets the requirements set out in Article 297:

- (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. Competent authorities shall report to EBA a list of the contractual cross-product netting agreements approved.

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 296

**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 a country other than that 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 point (a) of paragraph 2 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 point (b) of paragraph 2 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 297

##### 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 296(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 the case of contractual cross-product netting agreements referred to in Article 295, the institution shall maintain procedures under Article 296(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 296(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 298

##### 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 274(1);

(ii) the notional principal amounts or underlying values referred to in Article 274(2).

In the application of Section 4, in determining the notional amount referred to in Article 275(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 274(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 274(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 formula set out in paragraph 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.

In the application of Article 275(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 299

#### 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 set out in the first subparagraph 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 222 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 204, 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 300

#### Definitions

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

(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 respectively, 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 those that provided those assets;

(2) 'CCP-related transaction' means a contract or a transaction listed in Article 301(1) between a client and a clearing member that is directly related to a contract or a transaction listed in that paragraph between that clearing member and a CCP;

(3) 'clearing member' means a clearing member as defined in point (14) of Article 2 of Regulation (EU) No 648/2012;

(4) 'client' means a client as defined in point (15) of Article 2 of Regulation (EU) No 648/2012 or an undertaking that has established indirect clearing arrangements with a clearing member in accordance with Article 4(3) of that Regulation.

#### Article 301

#### 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 may choose whether to apply one of the following two treatments to the contracts and transactions outstanding with a  $Q_{CCP}$  listed in paragraph 1:

- (a) the treatment for trade exposures and exposures from default fund contributions set out in Article 306, except for the treatment set out in paragraph 1(b) of that Article, and in Article 307, respectively;
- (b) the treatment set out in Article 310.

3. Institutions shall apply the treatment set out in Article 306, except for the treatment set out in paragraph (1)(a) of that Article, and in Article 309, as applicable, to the contracts and transactions outstanding with a non-qualifying CCP listed in paragraph 1 of this Article.

#### *Article 302*

##### **Monitoring of exposures to CCPs**

1. Institutions shall monitor all their exposures to CCPs and shall lay down procedures for the regular reporting of information on those exposures to senior management and appropriate committee or committees of the management body.
2. Institutions shall assess, through appropriate scenario analysis and stress testing, whether the level of own funds held against exposures to a CCP, including potential future credit exposures, exposures from default fund contributions and, where the institution is acting as a clearing member, exposures resulting from contractual arrangements as laid down in Article 304, adequately relates to the inherent risks of those exposures.

#### *Article 303*

##### **Treatment of clearing members' exposures to CCPs**

1. 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 Article 301(2) and (3).
2. 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 Sections 1 to 8 of this Chapter, as applicable.
3. 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 Sections 1 to 8 of this Chapter, as applicable.

4. As an alternative to the approach specified in paragraph 3, where an institution is a client, it may calculate the own funds requirements for its CCP-related transactions with the clearing member in accordance with Article 305(2) 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 within the meaning of Article 39 of Regulation (EU) No 648/2012, 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 ensure that in the event of default or insolvency of the clearing member, the transfer of the institution's positions relating to those contracts and transactions and of the corresponding collateral to another clearing member within the relevant margin period of risk.

5. Where an institution acting as a clearing member enters into a contractual arrangement with a client of another clearing member in order to ensure that client the portability of assets and positions referred to in point (b) of paragraph 4, that institution may attribute an exposure value of zero to the contingent obligation that is created due to that contractual arrangement.

#### *Article 304*

##### **Treatment of clearing members' exposures to clients**

1. 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 Sections 1 to 8 of this Chapter and with Title VI of Part Three, as applicable.
2. Where an institution acting as a clearing member enters into a contractual arrangement with a client of another clearing member that facilitates, in accordance with Article 48(5) and (6), of Regulation (EU) No 648/2012, the transfer of positions and collateral referred to in Article 305(2)(b) of this Regulation for that client, and that contractual agreement gives rise to a contingent obligation for that institution, that institution may attribute an exposure value of zero to that contingent obligation.

3. An institution acting as a clearing member may apply a shorter margin period of risk when calculating the own fund requirement for its exposures to a client in accordance with the Internal Model Method. The margin period of risk applied by the institution shall not be less than five days.

4. An institution acting as a clearing member may multiply its EAD by a scalar when calculating the own fund requirement for its exposures to a client in accordance with the Mark-to-Market Method, the Standardised Method or the Original Exposure Method. The scalars that the institutions may apply are the following:

- (a) 0,71 for a margin period of risk of five days;
- (b) 0,77 for a margin period of risk of six days;
- (c) 0,84 for a margin period of risk of seven days;
- (d) 0,89 for a margin period of risk of eight days;
- (e) 0,95 for a margin period of risk of nine days;
- (f) 1 for a margin period of risk of ten days or more.

5. EBA shall develop draft regulatory technical standards to specify the margin periods of risk that institutions may use for the purposes of paragraphs 3 and 4.

When developing those draft regulatory technical standards, EBA shall apply the following principles:

- (a) it shall define the margin period of risk for each of the types of contracts and transactions listed in Article 301(1);
- (b) the margin periods of risk to be defined in point (a) shall reflect the close-out period of the contracts and transactions referred to in that point.

EBA shall submit those draft regulatory technical standards to the Commission by 30 June 2014.

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

#### Article 305

#### Treatment of clients' exposures

1. Where an institution is a client, it shall calculate the own funds requirements for its CCP-related transactions with its clearing member in accordance with Sections 1 to 8 of this Chapter and with Title VI of Part Three, as applicable.

2. Without prejudice to the approach specified in paragraph 1, where an institution is a client, it may calculate the own funds requirements for its trade exposures for CCP-related transactions with its clearing member in accordance with Article 306 provided that all 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 distinction and 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) laws, regulations, rules and contractual arrangements applicable to or binding that institution or the CCP facilitate the transfer of the client's positions relating to those contracts and transactions and of the corresponding collateral to another clearing member within the applicable margin period of risk in the event of default or insolvency of the original clearing member. In such circumstance, the client's positions and the collateral shall be transferred at market value unless the client requests to close out the position at market value;
- (c) the institution has available an independent, written and reasoned legal opinion that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the client would bear no losses on account of the insolvency of its clearing member or of any of its clearing member's clients under the laws of the jurisdiction of the institution, its clearing member and the CCP, the law governing the transactions and contracts the institution clears through the CCP, the law governing the collateral, and the law governing any contract or agreement necessary to meet the condition in point (b);
- (d) the CCP is a  $Q_{CCP}$ .

3. Without prejudice to the conditions specified in paragraph 2, where an institution that is a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default, but all the other conditions set out in paragraph 2 are met, the client may calculate the own funds requirements for its trade exposures for CCP-related transactions with its clearing member in accordance with Article 306, subject to replacing the 2 % risk weight in paragraph 1(a) of that Article with a 4 % risk weight.



4. Where an institution that is a client accesses the services of a CCP through indirect clearing arrangements, in accordance with Article 4(3) of Regulation (EU) No 648/2012, that institution may apply the treatment set out in paragraph 2 or 3 only where the conditions in each paragraph are met at every level of the chain of intermediaries.

#### Article 306

##### Own funds requirements for trade exposures

1. An institution shall apply the following treatment to its trade exposures with CCPs:

- (a) it shall apply a risk weight of 2 % to the exposure values of all its trade exposures with QCCPs;
- (b) it shall apply the risk weight used for the Standardised Approach to credit risk as set out in Article 107(2)(b) to all its trade exposures with non-qualifying CCPs;
- (c) where an institution is acting as a financial intermediary between a client and a CCP and the terms of the CCP-related transaction stipulate that the institution is not obligated to reimburse the client for any losses suffered due to changes in the value of that transaction in the event that the CCP defaults, the exposure value of the transaction with the CCP that corresponds to that CCP-related transaction is equal to zero.

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 Sections 1 to 8 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 Article 92(3) as the sum of the exposure values of its trade exposures with CCPs, calculated in accordance with paragraphs 2 and 3 of this Article, multiplied by the risk weight determined in accordance with paragraph 1 of this Article.

#### Article 307

##### Own funds requirements for pre-funded contributions to the default fund of a CCP

An institution acting as a clearing member shall apply the following treatment to its exposures arising from its contributions to the default fund of a CCP:

- (a) it shall calculate the own funds requirement for its pre-funded contributions to the default fund of a QCCP in accordance with the approach set out in Article 308;
- (b) it shall calculate the own funds requirement for its pre-funded contributions to the default fund of a non-qualifying CCP in accordance with the approach set out in Article 309.

#### Article 308

##### Own funds requirements for pre-funded contributions to the default fund of a QCCP

1. The exposure value for an institution's pre-funded contribution to the default fund of a QCCP ( $DF_i$ ) shall be the amount paid in or the market value of the assets delivered by that institution reduced by any amount of that contribution that the QCCP has already used to absorb its losses following the default of one or more of its clearing members.

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 ( $\sum_i K_i$ ).

3. An institution shall calculate  $K_{CM}$  as follows:

(a) where  $K_{CCP} \leq DF_{CCP}$ , the institution shall use the following formula:

$$K_{CM} = c_1 \cdot DF_{CM}^*$$

(b) where  $DF_{CCP} < K_{CCP} \leq DF^*$ , the institution shall use the following formula:

$$K_{CM} = c_2 \cdot (K_{CCP} - DF_{CCP}) + c_1 \cdot (DF^* - K_{CCP});$$

(c) where  $DF^* < K_{CCP}$ , the institution 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;

$DF^*$  =  $DF_{CCP} + DF_{CM}^*$ ;

$DF_{CM}^*$  =  $DF_{CM} - 2 \cdot \overline{DF}_i$ ;

$\overline{DF}_i$  = the average pre-funded contribution,  $\frac{1}{N} \cdot DF_{CM}$ , communicated to the institution by the CCP;

$c_1$  = a capital factor equal to  $\max \left\{ \frac{1.6\%}{\left( \frac{DF^*}{K_{CCP}} \right)^{0.3}}, 0.16\% \right\}$

$c_2$  = a capital factor equal to 100 %;

$\mu$  = 1,2.

4. An institution shall calculate the risk weighted exposure amounts for exposures arising from an institution's pre-funded contribution for the purposes of Article 92(3) as the own funds requirement ( $K_i$ ) determined in accordance with paragraph 2 multiplied by 12,5.

5. 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 paragraph 3.

#### Article 309

##### **Own funds requirements for pre-funded contributions to the default fund of a non-qualifying CCP and for unfunded contributions to a non-qualifying CCP**

1. An institution shall apply the following formula to calculate the own funds requirement ( $K_i$ ) for the exposures arising from its pre-funded contributions to the default fund of a non-qualifying CCP ( $DF_i$ ) and from unfunded contributions ( $UC_i$ ) to such CCP:

$$K_i = c_2 \cdot \mu \cdot (DF_i + UC_i)$$

where  $c_2$  and  $\mu$  are defined as in Article 308(3).

2. For the purpose of paragraph 1, unfunded contributions means contributions that an institution acting as a clearing member has contractually committed to provide to a CCP after the CCP has depleted its default fund to cover the losses it incurred following the default of one or more of its clearing members.

3. An institution shall calculate the risk weighted exposure amounts for exposures arising from an institution's pre-funded contribution for the purposes of Article 92(3) as the own funds requirement ( $K_i$ ) determined in accordance with paragraph 1 multiplied by 12,5.

#### Article 310

##### **Alternative calculation of own funds requirement for exposures to a QCCP**

An institution shall apply the following formula to calculate the own funds requirement ( $K_i$ ) for the exposures arising from its trade exposures and the trade exposures of its clients ( $TE_i$ ) and pre-funded contributions ( $DF_i$ ) to the default fund of a QCCP:

$$K_i = 8\% \cdot \min[2\% \cdot TE_i + 1250\% \cdot DF_i; 20\% \cdot TE_i]$$

#### Article 311

##### **Own funds requirements for exposures to CCPs that cease to meet certain conditions**

1. An institution shall apply the treatment set out in this Article where one or both of the following conditions have been met:

- the institution has received from a CCP a notification required by point (j)(ii) of Article 50b of Regulation (EU) No 648/2012 that the CCP has stopped calculating  $K_{CCP}$ ;
- it has become known to the institution, following a public announcement or notification from the competent authority of a CCP used by the institution or from that CCP itself, that the CCP will no longer comply with the conditions for authorisation or recognition, as applicable.

2. Where only the condition in point (a) of paragraph 1 has been met, the competent authority of the institution shall verify the reasons why the CCP has stopped calculating  $K_{CCP}$ .

Where the competent authority considers that the reasons referred to in the first subparagraph are valid, it may permit institutions in its Member State to apply the treatment set out in Article 310 to their trade exposures and default fund contributions to that CCP. Where it grants such permission, it shall disclose the reasons for its decision.

Where the competent authority considers that the reasons referred to in the first subparagraph are not valid, all institutions in its Member State, irrespective of the treatment they chose in accordance with Article 301(2), shall apply the treatment set out in points (a) to (d) of paragraph 3 of this Article.

3. Where the condition in point (b) of paragraph 1 has been met, irrespective of whether the condition in point (a) of that paragraph has been met or not, an institution shall, within three months of the circumstance set out in point (b) of that paragraph arising, or earlier where the competent authority of the institution requires it, do the following with respect to its exposures to that CCP:

- cease to apply the treatment it chose in accordance with Article 301(2);
- apply the treatment set out in point (b) of Article 306(1) to its trade exposures to that CCP;

- (c) apply the treatment set out in Article 309 to its pre-funded contributions to the default fund of that CCP and to its unfunded contributions to that CCP;
- (d) treat exposures other than those listed in points (b) and (c) to that CCP as exposures to a corporate in accordance with the Standardised Approach for credit risk as set out in Chapter 2.

## TITLE III

## OWN FUNDS REQUIREMENTS FOR OPERATIONAL RISK

## CHAPTER 1

**General principles governing the use of the different approaches**

## Article 312

**Permission and notification**

1. To qualify for use of the Standardised Approach, institutions shall meet the criteria set out in Article 320, in addition to meeting the general risk management standards set out in Articles 74 and 85 of Directive 2013/36/EU. 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 of retail banking and commercial banking where the conditions set out in Articles 319(2) and 320 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 321 and 322 respectively are met and where institutions meet the general risk management standards set out in Articles 74 and 85 of Directive 2013/36/EU 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. Institutions shall notify the competent authorities of all changes to their Advanced Measurement Approaches models.

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

- (a) the assessment methodology under which the competent authorities permit institutions to use Advanced Measurement Approaches;
- (b) the conditions for assessing the materiality of extensions and changes to the Advanced Measurement Approaches;

- (c) the modalities of the notification required 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

## Article 313

**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 314

**Combined use 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 of 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 320 and the standards set out in Articles 321 and 322 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:

(a) on the date of implementation of an Advanced Measurement Approach, a significant part of the institution's operational risks are captured by that Approach;

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

## CHAPTER 2

### **Basic indicator approach**

#### *Article 315*

#### **Own funds requirement**

1. 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 set out in Article 316.

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.

2. 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.

3. Where an institution can prove to its competent authority that, due to a merger, an acquisition 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 the institution to amend the calculation in a way that would take into account such events and shall duly inform EBA thereof. In such circumstances, the competent authority may, on its own initiative, also require an institution to amend the calculation.

4. 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 316*

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

#### CHAPTER 3

### Standardised Approach

#### Article 317

### 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 318.

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, an acquisition 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 amend the calculation in a way that would take into account such events and shall duly inform EBA thereof. In such circumstances, the competent authority may, on its own initiative, also require an institution to amend 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	Underwriting of financial instruments or placing of financial instruments on a firm commitment basis Services related to underwriting Investment advice Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of undertakings Investment research and financial analysis and other forms of general recommendation relating to transactions in financial instruments	18 %



Business line	List of activities	Percentage (beta factor)
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 natural persons or with SMEs meeting the criteria set out in Article 123 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 natural persons or with SMEs meeting the criteria set out in Article 123 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 318

##### 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 317. 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 Article 15 of Regulation (EU) No 1093/2010.

#### Article 319

##### 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, an 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 PD;
- (c) the Alternative Standardised Approach provides an appropriate basis for calculating its own funds requirement for operational risk.

#### *Article 320*

##### **Criteria for the Standardised Approach**

The criteria referred to in the first subparagraph of Article 312(1) are the following:

- (a) an institution shall have in place a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system. It shall identify its 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 institution's 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) an institution shall implement a system of reporting to senior management that provides operational risk reports to relevant functions within the institution. An institution shall have in place procedures for taking appropriate action according to the information within the reports to management.

#### *CHAPTER 4*

##### **Advanced measurement approaches**

#### *Article 321*

##### **Qualitative standards**

The qualitative standards referred to in Article 312(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) an institution shall have an independent risk management function for operational risk;
- (c) an institution 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. An institution shall have in place routines for ensuring compliance and policies for the treatment of non-compliance;
- (e) an institution shall subject its 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 risk measurement system shall be transparent and accessible.

#### *Article 322*

##### **Quantitative Standards**

1. The quantitative standards referred to in Article 312(2) include the standards relating to process, to internal data, to external data, to scenario analysis, to business environment and to internal control factors laid down in paragraphs 2 to 6 respectively.

2. The standards relating to process are the following:

- (a) an institution shall calculate its own funds requirement as comprising both expected loss and unexpected loss, unless expected loss is adequately captured in its 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 institution's 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) an institution may recognise correlations in operational risk losses across individual operational risk estimates only where its 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. An institution shall validate its 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) an institution shall base its 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) an institution shall be able to map their historical internal loss data into the business lines defined in Article 317 and into the event types defined in Article 324, 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". An institution shall have in place documented, objective criteria for allocating losses to the specified business lines and event types. An institution shall record the operational risk losses that are related to credit risk and that the institution has 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, provided that the institution is required to continue to treat them as credit risk for the purposes of calculating own funds requirements. An institution 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. An institution 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. An institution shall define appropriate minimum loss thresholds for internal loss data collection;
  - (d) aside from information on gross loss amounts, an institution 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) an institution 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) an institution 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) an institution 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) an institution 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) an institution 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, an institution shall validate and reassess the process and the outcomes through comparison to actual internal loss experience and relevant external data.

*Article 323*

**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 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 324*

**Loss event type classification**

The loss events types referred to in point (b) of Article 322(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 325*

**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 326

#### 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.

#### Article 327

#### 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 328 to 330. Institutions' holdings of their own debt instruments shall be disregarded in calculating specific risk capital requirements under Article 336.

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 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, shall be converted on a daily basis into the institution's reporting currency at the prevailing spot exchange rate before their aggregation.

#### Article 328

#### 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 336 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 336 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 329

#### 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 be that of the exchange concerned. For OTC-options, or where delta is not available from the exchange concerned, the institution may calculate delta itself using an appropriate model, subject to permission by the competent authorities. 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 subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

4. Before the entry into force of the technical standards referred to in paragraph 3, competent authorities may continue to apply the existing national treatments, where the competent authorities have applied those treatments before 31 December 2013.

#### Article 330

##### 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 331

##### 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 328 to 330 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 339. 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 328 to 330 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 332

##### 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 shall 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 shall 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 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. 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 in accordance with Article 338(1) or (3) shall be included only in the determination of the specific risk own funds requirement in accordance with Article 338(4).

#### Article 333

##### **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 334

##### **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 335

##### **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 336

##### **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 327 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.

Table 1

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 set out in Article 129(4), (5) and (6) as half of the applicable specific risk own funds requirement for the second category in Table 1.

4. Other qualifying items are:

- (a) long and short positions in assets for which a credit assessment by a nominated ECAI 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 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;

- (b) 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;
- (c) 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 2013/36/EU.

Institutions that make use of point (a) or (b) 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 337

##### 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 327(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 Title II, Chapter 5, Section 3;
- (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 Title II, Chapter 5, Section 3.

2. The Supervisory Formula Method set out in Article 262 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 Title II, Chapter 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 first subparagraph.

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 Title II, Chapter 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 407, 8 % of the total risk weight shall be applied.

Except for securitisation positions treated in accordance with Article 338(4), 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.

4. By way of derogation from the second subparagraph of paragraph 3, for a transitional period ending 31 December 2014, 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 competent authority of the home Member State the total sum of its weighted net long and net short positions, broken down by types of underlying assets.

5. Where an originator institution of a traditional securitisation does not meet the conditions for significant risk transfer in Article 243, it shall include in the calculation of the own funds requirement under this Article the securitised exposures instead of its securitisation positions from this securitisation.

Where an originator institution of a synthetic securitisation does not meet the conditions for significant risk transfer in Article 244, it shall include in the calculation of the own funds requirement under this Article the securitised exposures from this securitisation, but not any credit protection obtained for the securitised portfolio.

#### Article 338

#### **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 exposures' 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 in accordance with paragraph 1 and this paragraph.

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 339

**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		Weighting (in %)	Assumed interest rate change (in %)
	Coupon of 3 % or more	Coupon of less than 3 %		
One	0 ≤ 1 month	0 ≤ 1 month	0,00	—
	> 1 ≤ 3 months	> 1 ≤ 3 months	0,20	1,00
	> 3 ≤ 6 months	> 3 ≤ 6 months	0,40	1,00
	> 6 ≤ 12 months	> 6 ≤ 12 months	0,70	1,00
Two	> 1 ≤ 2 years	> 1,0 ≤ 1,9 years	1,25	0,90
	> 2 ≤ 3 years	> 1,9 ≤ 2,8 years	1,75	0,80
	> 3 ≤ 4 years	> 2,8 ≤ 3,6 years	2,25	0,75
Three	> 4 ≤ 5 years	> 3,6 ≤ 4,3 years	2,75	0,75
	> 5 ≤ 7 years	> 4,3 ≤ 5,7 years	3,25	0,70
	> 7 ≤ 10 years	> 5,7 ≤ 7,3 years	3,75	0,65
	> 10 ≤ 15 years	> 7,3 ≤ 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 paragraphs 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 340

##### 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 339, 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 339(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 341

#### 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 327. 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 January 2014.

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

##### Article 342

#### 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 343

#### General risk of equity instruments

The own funds requirement against general risk shall be the institution's overall net position multiplied by 8 %.

##### Article 344

#### Stock indices

1. EBA shall develop draft implementing technical standards listing the stock indices for which the treatments set out in the second sentence of paragraph 4 is available.

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 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 2014.

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 that 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 a relevant appropriately diversified index.

### Section 4

#### Underwriting

##### Article 345

#### 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 346

#### 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 paragraph 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 347

### 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 in accordance with Article 346:

- (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 336;

(b) where the *n*th 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 in point (a) for first-to-default credit derivatives shall be followed appropriately amended for *n*th-to-default products.

## Section 6

### Own funds requirements for CIUs

#### Article 348

#### 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 353 taken together with the amended gold treatment set out in Article 352(4) and Article 367(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 350, no netting is permitted between the underlying investments of a CIU and other positions held by the institution.

#### Article 349

#### General criteria for CIUs

CIUs shall be eligible for the approach set out in Article 350, 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 in accordance with Directive 2009/65/EC or equivalent legislation.

#### Article 350

#### 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 such an 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, provided that 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) the 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 coefficient between daily returns on the CIU and the index or basket of equities or debt securities it tracks of 0,9 can be clearly established over a minimum period of six months.

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 in accordance with this paragraph exceed that set out in Article 348(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 Article 132(3)(a).

The correctness of the calculation shall be confirmed by an external auditor.

#### CHAPTER 3

### **Own funds requirements for foreign-exchange risk**

#### Article 351

#### **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 352, 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 352

#### **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 that of the exchange concerned. For OTC options, or where delta is not available from the exchange concerned, the institution may calculate delta itself using an appropriate model, subject to permission by the competent authorities. 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 accordance with Article 92(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 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 first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

Before the entry into force of the technical standards referred to in the first subparagraph, competent authorities may continue to apply the existing national treatments, where the competent authorities have applied those treatments before 31 December 2013.

#### Article 353

##### Foreign exchange risk of CIUs

1. For the purposes of Article 352, 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 Article 132(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 addition of the total long position to the total long open foreign exchange position and the total short position to the total short open foreign exchange position where the direction of the CIU's investment is available. There shall be no netting allowed between such positions prior to the calculation.

#### Article 354

##### Closely correlated currencies

1. Institutions may provide lower own funds requirements against positions in relevant 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, and 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 for which the treatment set out in paragraph 1 is available.

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 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 in accordance with Article 352(4).

6. Where daily exchange-rate data for the preceding three or five years - occurring on equal and opposite positions in a pair of currencies over the following 10 working days show that these two currencies are perfectly positively correlated and the institution always can face a zero bid/ask spread on the respective trades, the institution can, upon explicit permission by its competent authority, apply an own funds requirement of 0 % until the end of 2017.

#### CHAPTER 4

### **Own funds requirements for commodities risk**

#### *Article 355*

#### **Choice of method for commodities risk**

Subject to Articles 356 to 358, institutions shall calculate the own funds requirement for commodities risk with one of the methods set out in Article 359, 360 or 361.

#### *Article 356*

#### **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 EUR 1 million 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 357*

### **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 in accordance with Chapter 3 or 5, as appropriate, for the purpose of calculating commodities risk.

3. For the purpose of Article 360(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 358, as positions in the underlying commodity.

4. 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 358*

### **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 359(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 be that of the exchange concerned. For OTC options, or where delta is not available from the exchange concerned the institution may calculate delta itself using an appropriate model, subject to permission by the competent authorities. 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 subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

Before the entry into force of the technical standards referred to in the first subparagraph, competent authorities may continue to apply the existing national treatments, where the competent authorities have applied those treatments before 31 December 2013.

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 359

##### 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 ≤ 1 month	1,50
> 1 ≤ 3 months	1,50
> 3 ≤ 6 months	1,50
> 6 ≤ 12 months	1,50
> 1 ≤ 2 years	1,50
> 2 ≤ 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 in accordance with paragraph 5.

#### Article 360

##### 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 in accordance with paragraph 1.

#### Article 361

##### 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 359 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.

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

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.

#### CHAPTER 5

##### Use of internal models to calculate own funds requirements

#### Section 1

##### Permission and own funds requirements

#### Article 362

##### 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 363

##### 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 a significant share of the positions of a certain risk category.

3. Material changes to the use of internal models that the institution has received permission to use, the extension of the use of internal models that the institution has received permission to use, in particular to additional risk categories, and the initial calculation of stressed value-at-risk in accordance with Article 365(2) require a separate permission by the competent authority.

Institutions shall notify the competent authorities of all other extensions and changes to the use of those internal models that the institution has received permission to use.

4. 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;
- (c) the conditions under which the share of positions covered by the internal model within a risk category shall be considered significant as referred to in paragraph 2.

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

#### Article 364

##### Own funds requirements when using internal models

1. Each institution using an internal model shall fulfil, in addition to own funds requirements calculated in accordance with 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 365(1) ( $VaR_{t-1}$ );
  - (ii) an average of the daily value-at-risk numbers calculated in accordance with Article 365(1) on each of the preceding sixty business days ( $VaR_{avg}$ ), multiplied by the multiplication factor ( $m_c$ ) in accordance with Article 366;

(b) the higher of the following values:

- (i) its latest available stressed-value-at-risk number calculated in accordance with Article 365(2) ( $sVaR_{t-1}$ ); and
- (ii) an average of the stressed value-at-risk numbers calculated in the manner and frequency specified in Article 365(2) during the preceding sixty business days ( $sVaR_{avg}$ ), multiplied by the multiplication factor ( $m_c$ ) in accordance with Article 366;

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 337 and 338 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 350(1) nor Article 350(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 338(1) to (3), may fulfil an own funds requirement on the basis of Article 377 instead of Article 338(4), 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 338(4) for all those positions incorporated into the internal model for the correlation trading portfolio.



## Section 2

**General requirements***Article 365***VaR and stressed VaR Calculation**

1. The calculation of the value-at-risk number referred to in Article 364 shall be subject to the following requirements:

- (a) daily calculation of the value-at-risk number;
- (b) a 99th 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 366***Regulatory back testing and multiplication factors**

1. The results of the calculations referred to in Article 365 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 365(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 367***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 that 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 353(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 shall 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 368

##### 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 those 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 those 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 those used for purposes of this Chapter.

2. The review referred to in point (h) of paragraph 1 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 369

##### 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 370***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 shall 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 371***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 332(1)(e) or Article 337 with exception of those positions that are subject to the approach set out in Article 377.

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 372***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 365(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 Article 367(3), Article 368, Article 369(1) and points (b), (c), (e) and (f) of Article 370 are met.

EBA shall issue guidelines on the requirements in Articles 373 to 376.

*Article 373***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 336, 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 374***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 375

##### 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 shall be reflected in the own funds requirement.

#### Article 376

##### 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.

## Section 5

### Internal model for correlation trading

#### Article 377

#### 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 in accordance with Article 338 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 of this Article and in Article 367(1) and (3), Article 368, Article 369(1) and points (a), (b), (c), (e) and (f) of Article 370.

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 issue 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 378

#### 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 difference is calculated as the 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 379

#### 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 161(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 36(1).

#### Article 380

##### Waiver

Where a system wide failure of a settlement system, a clearing system or a CCP occurs, competent authorities may waive the own funds requirements calculated as set out in Articles 378 and 379 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 381

##### 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 382

##### 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. Transactions with a qualifying central counterparty and a client's transactions with a clearing member, when the clearing member is acting as an intermediary between the client and a qualifying central counterparty and the transactions give rise to a trade exposure of the clearing member to the qualifying central counterparty, are excluded from the own funds requirements for CVA risk.

4. The following transactions shall be excluded from the own funds requirements for CVA risk:

(a) transactions with non-financial counterparties as defined in point (9) of Article 2 of Regulation (EU) No 648/2012, or

with non-financial counterparties established in a third country, where those transactions do not exceed the clearing threshold as specified in Article 10(3) and (4) of that Regulation;

(b) intragroup transactions as provided for in Article 3 of Regulation (EU) No 648/2012 unless Member States adopt national laws requiring the structural separation within a banking group, in which case competent authorities may require those intragroup transactions between the structurally separated institutions to be included in the own funds requirements;

(c) transactions with counterparties referred to in point (10) of Article 2 of Regulation (EU) No 648/2012 and subject to the transitional provisions set out in Article 89(1) of that Regulation until those transitional provisions cease to apply;

(d) transactions with counterparties referred to in Article 1(4)(a) and (b) and Article 1(5)(a), (b) and (c) of Regulation (EU) No 648/2012 and transactions with counterparties for which Article 115 of this Regulation specifies a risk weight of 0 % for exposures to those counterparties.

The exemption from the CVA charge for those transactions referred to in point (c) of this paragraph which are entered into during the transitional period laid down in Article 89(1) of Regulation (EU) No 648/2012 shall apply for the length of the contract of that transaction.

5. EBA shall conduct a review by 1 January 2015 and every two years thereafter, in the light of international regulatory developments and including on potential methodologies on the calibration and thresholds for application of CVA charges to non-financial counterparties established in a third country.

EBA in cooperation with ESMA shall develop draft regulatory technical standards to specify the procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirement for CVA risk.

EBA shall submit those draft regulatory technical standards within six months of the date of the review referred to in the first subparagraph,

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

## Article 383

**Advanced method**

1. An institution which has permission to use an internal model for the specific risk of debt instruments in accordance with point (d) of Article 363 (1) 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 283, 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 those transactions, taking into account CVA hedges that are eligible in accordance with Article 386.

An institution shall use its internal model for determining the own funds requirements for the specific risk associated with traded debt positions and shall apply a 99 % 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:

$$CVA = LGD_{MKT} \cdot \sum_{i=1}^T \max \left\{ 0, \exp \left( - \frac{s_{i-1} \cdot t_{i-1}}{LGD_{MKT}} \right) - \exp \left( - \frac{s_i \cdot t_i}{LGD_{MKT}} \right) \right\} \cdot \frac{EE_{i-1} \cdot D_{i-1} + EE_i \cdot D_i}{2}$$

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 LGD 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  $t_i$ , 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 set out 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 285(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):

(a) where the model is based on full repricing, the formula in paragraph 1 shall be used directly;

(b) 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

$$\text{Regulatory CSO1}_T = 0.0001 \cdot t_T \cdot \exp\left(-\frac{s_T \cdot t_T}{\text{LGD}_{\text{MKT}}}\right) \cdot \frac{EE_{T-1} \cdot D_{T-1} + EE_T \cdot D_T}{2}$$

- (c) where the model uses credit spread sensitivities to parallel shifts in credit spreads, an institution shall use the following formula:

$$\text{Regulatory CSO1} = 0.0001 \cdot \sum_{i=1}^T \left( t_i \cdot \exp\left(-\frac{s_i \cdot t_i}{\text{LGD}_{\text{MKT}}}\right) - t_{i-1} \cdot \exp\left(-\frac{s_{i-1} \cdot t_{i-1}}{\text{LGD}_{\text{MKT}}}\right) \right) \cdot \frac{EE_{i-1} \cdot D_{i-1} + EE_i \cdot D_i}{2}$$

- (d) 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 285(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 285(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 283 to use IMM to calculate exposure values in relation to the majority of its business, but which uses the methods set out in Section 3, Section 4 or Section 5 of Title II, Chapter 6 for smaller portfolios, and which has permission to use the market risk internal model for the specific risk of debt instruments in accordance with point (d) of Article 363(1) 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 methods 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 Article 364(1) and Articles 365 and 367 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 the first subparagraph of Article 292(2), shall be used;
- (b) for the stressed Value-at-Risk, future counterparty EE profiles using a stressed calibration as set out in the second subparagraph of Article 292(2) 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 used in the calculation of own funds requirements based on a Value-at-Risk and a stressed Value-at-Risk in accordance with 364(1) will apply to these calculations. EBA shall monitor for consistency any supervisory discretion used to apply a higher multiplier than that three-times multiplier to the Value-at-Risk and stressed Value-at-Risk inputs to the CVA charge. Competent authorities applying a multiplier higher than three shall provide a written justification to EBA;
- (d) the calculation shall be carried out on at least a monthly basis and the EE that is used shall be calculated on the same frequency. If lower than a daily frequency is used, for the purpose of the calculation specified in points (a)(ii) and (b)(ii) of Article 364(1) institutions shall take the average over three months.

6. For exposures to a counterparty, for which the institution's approved internal model for the specific risk of debt instruments does not produce a proxy spread that is appropriate with respect to the criteria of rating, industry and region of the counterparty, the institution shall use the method set out in Article 384 to calculate the own funds requirement for CVA risk.



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

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

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

#### Article 384

#### Standardised method

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

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

where:

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

$w_i$  = the weight applicable to counterparty "i".

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Table 1

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

#### Article 385

##### Alternative to using CVA methods to calculating own funds requirements

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

#### Article 386

##### Eligible hedges

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

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

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

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

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

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

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

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

## PART FOUR

**LARGE EXPOSURES***Article 387***Subject matter**

Institutions shall monitor and control their large exposures in accordance with this Part.

*Article 388***Negative Scope**

This Part shall not apply to investment firms that fulfil the criteria set out in Article 95(1) or Article 96(1).

This Part shall not apply to a group on the basis of its consolidated situation, if that group only includes investment firms referred to in Article 95(1) or Article 96(1) and ancillary companies and where that group does not include credit institutions.

*Article 389***Definition**

For the purposes of this Part, 'exposures', means any asset or off-balance sheet item referred to in Part Three, Title II, Chapter 2, without applying the risk weights or degrees of risk.

*Article 390***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 283 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 institutions that calculate the own funds requirements for their trading-book business in accordance with Part Three, Title IV, Chapter 2, Article 299 and Part Three, Title V and, as appropriate, with Part Three, Title IV, Chapter 5, shall calculate the exposures to individual clients which arise on the trading book by adding together 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 299 and 378 to 380 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 345.

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 299.

4. The overall exposures to individual clients or groups of connected clients shall be calculated by adding together 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 adding together 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 36, 56 and 66.

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 (m) and (o) of Article 112 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:

- (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;
- (b) the conditions under which the structure of the transaction referred to in paragraph 7 does not constitute an additional exposure.

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

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

#### Article 391

##### Definition of an institution for large exposures purposes

For the purposes of calculating the value of exposures in accordance with this Part the term 'institution' shall include a private or public undertaking, including its branches, which, were it established in the Union, would fulfil the definition of the term 'institution' and has been authorised in a third country that applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union.

#### Article 392

##### 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 393

##### 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 394

##### 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 395(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 395(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 395(1) shall be made available to the competent authorities.

2. An institution shall report the following information to the competent authorities, in addition to reporting the information referred to in paragraph 1, in relation to its 10 largest exposures on a consolidated basis to institutions as well as its 10 largest exposures on a consolidated basis to unregulated financial entities, including large exposures exempted from the application of Article 395(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 395(1);
- (e) the expected run-off of the exposure expressed as the amount maturing within monthly maturity buckets up to one year, quarterly maturity buckets up to three years and annually thereafter.

3. Reporting shall be carried out at least twice a year.

4. EBA shall develop draft implementing technical standards to specify the following:

- (a) the uniform formats for the reporting referred to in paragraph 3 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 3;
- (c) the IT solutions to be applied for the reporting referred to in paragraph 3.

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 Article 15 of Regulation (EU) No 1093/2010.

#### Article 395

##### Limits to large exposures

1. An institution shall not incur an exposure, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403, 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 399 to 403, 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 399 to 403 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 81 of Directive 2013/36/EU, 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. EBA shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, taking into account the effect of the

credit risk mitigation in accordance with Articles 399 to 403 as well as the outcomes of developments in the area of shadow banking and large exposures at the Union and international levels, issue guidelines by 31 December 2014 to set appropriate aggregate limits to such exposures or tighter individual limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework.

In developing those guidelines, EBA shall consider whether the introduction of additional limits would have a material detrimental impact on the risk profile of institutions established in the Union, on the provision of credit to the real economy or on the stability and orderly functioning of financial markets.

By 31 December 2015 the Commission shall assess the appropriateness and the impact of imposing limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework, taking into account Union and international developments in the area of shadow banking and large exposures as well as credit risk mitigation in accordance with Articles 399 to 403. The Commission shall submit the report to the European Parliament and the Council, together, if appropriate, with a legislative proposal on exposure limits to shadow banking entities which carry out banking activities outside a regulated framework.

3. Subject to Article 396, an institution shall at all times comply with the relevant limit laid down in paragraph 1.

4. Assets constituting claims and other exposures onto recognised third-country investment firms may be subject to the same treatment as set out in paragraph 1.

5. 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 connected 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 397 and 398;
- (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 and, where applicable, the name of the group of connected clients concerned, without delay to the competent authorities.

6. For the purpose of this paragraph, structural measures mean measures adopted by a Member State and implemented by the relevant competent authorities of that Member State before the entry into force of a legal act explicitly harmonising such measures, that require credit institutions authorised in that Member State to reduce their exposures to different legal entities depending on their activities, irrespective of where those activities are located, with a view to protecting depositors and preserving financial stability.

Notwithstanding paragraph 1 of this Article and Article 400(1)(f), where Member States adopt national laws requiring structural measures to be taken within a banking group, competent authorities may require the institutions of the banking group which hold deposits that are covered by a Deposit Guarantee Scheme in accordance with Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes <sup>(1)</sup> or an equivalent deposit guarantee scheme in a third country to apply a large exposure limit below 25 % but not lower than 15 % between 31 December 2014 and 30 June 2015, and than 10 % from 1 July 2015 on a sub-consolidated basis in accordance with Article 11(5) to intragroup exposures where these exposures consist of exposures to an entity that does not belong to the same subgroup as regards the structural measures.

For the purpose of this paragraph, the following conditions shall be met:

- (a) all entities belonging to a same subgroup as regards the structural measures are considered as one client or group of connected clients;
- (b) the competent authorities apply a uniform limit to the exposures referred to in the first subparagraph.

Applying this approach shall be without prejudice to effective supervision on a consolidated basis and shall not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the Union as a whole or form or create an obstacle to the functioning of the internal market.

<sup>(1)</sup> OJ L 135, 31.5.1994, p. 5.

7. Before adopting the specific structural measures as referred to in paragraph 6 relating to large exposures, the competent authorities shall notify the Council, the Commission, the competent authorities concerned and EBA at least two months prior to the publication of the decision to adopt the structural measures, and submit relevant quantitative or qualitative evidence of all of the following:

- (a) the scope of the activities that are subject to the structural measures;
- (b) an explanation as to why such draft measures are deemed to be suitable, effective and proportionate to protect depositors;
- (c) an assessment of the likely positive or negative impact of the measures on the internal market based on information which is available to the Member State.

8. The power to adopt an implementing act to accept or reject the proposed national measures referred to in paragraph 7 is conferred on the Commission acting in accordance with the procedure referred to in Article 464(2).

Within one month of receiving the notification referred to in paragraph 7, EBA shall provide its opinion on the points mentioned in that paragraph to the Council, the Commission and the Member State concerned. Competent authorities concerned may also provide their opinions on the points mentioned in that paragraph to the Council, the Commission and the Member State concerned.

Taking utmost account of the opinions referred to in the second subparagraph and if there is robust and strong evidence that the measures have a negative impact on the internal market that outweighs the financial stability benefits, the Commission shall, within two months of receiving the notification, reject the proposed national measures. Otherwise, the Commission shall accept the proposed national measures for an initial period of 2 years and where appropriate the measures may be subject to amendment.

The Commission shall only reject the proposed national measures if it considers the proposed national measures entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the Union as a whole, thus forming or creating an obstacle to the functioning of the internal market or to the free movement of capital in accordance with the provisions of the TFEU.

The assessment of the Commission shall take account of the opinion of EBA and shall take into account the evidence presented in accordance with paragraph 7.

Before the expiry of the measures, the competent authorities may propose new measures for the extension of the period of application for an additional period of 2 years each time. In this case, they shall notify the Commission, the Council, the competent authorities concerned and EBA. Approval of the new measures shall be subject to the process set out in this Article. This Article shall be without prejudice to Article 458.

#### Article 396

##### Compliance with large exposures requirements

1. If, in an exceptional case, exposures exceed the limit set out in Article 395(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 institution a limited period of time in which to comply with the limit.

Where the amount of EUR 150 million referred to in Article 395(1) is applicable, the competent authorities may allow on a case-by-case basis the 100 % limit in terms of the institution's eligible capital to be exceeded.

2. Where compliance by an institution on an individual or sub-consolidated basis with the obligations imposed in this Part is disappplied under Article 7(1), or the provisions of Article 9 are applied in the case of parent institutions in a Member State, measures shall be taken to ensure the satisfactory allocation of risks within the group.

#### Article 397

##### Calculating additional own funds requirements for large exposures in the trading book

1. The excess referred to in Article 395(5)(b) shall be calculated by selecting those components of the total trading exposure to the client or group of connected clients in question which attract the highest specific-risk requirements in Part Three, Title IV, Chapter 2 and/or requirements in Article 299 and Part Three, Title V, the sum of which equals the amount of the excess referred to in point (a) of Article 395(5).

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 299 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 299 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 398

##### Procedures to prevent institutions from avoiding the additional own funds requirement

Institutions shall not deliberately avoid the additional own funds requirements set out in Article 397 that they would otherwise incur, on exposures exceeding the limit laid down in Article 395(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 399

##### Eligible credit mitigation techniques

1. For the purposes of Articles 400 to 403 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 400 to 403 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 401(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 Part, an institution shall not take into account the collateral referred to in Article 199(5) to (7), unless permitted under Article 402.

4. Institutions shall analyse, to the extent possible, their exposures to collateral issuers, providers of unfunded credit protection and underlying assets pursuant to Article 390(7) for possible concentrations and where appropriate take action and report any significant findings to their competent authority.

#### Article 400

##### Exemptions

1. The following exposures shall be exempted from the application of Article 395(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 113(6) or (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 395(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 395(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 of Article 129(1), (3) and (6);
- (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 395(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 and are not denominated in a major trading currency;
- (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 exposure amounts;
- (k) assets items constituting claims on and other exposures to recognised exchanges.
3. Competent authorities may only make use of the exemption provided for in paragraph 2 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 81 of Directive 2013/36/EU.
- Competent authorities shall inform EBA whether or not they intend to use any of the exemptions provided for in paragraph 2 in accordance with points (a) and (b) of this paragraph and shall consult EBA on this choice.

#### Article 401

#### Calculating the effect of the use of credit risk mitigation techniques

1. For calculating the value of exposures for the purposes of Article 395(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 395(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.

The estimates produced by the institution shall be sufficiently suitable for reducing the exposure value for the purposes of compliance with the provisions of Article 395.

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 403(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 395(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 periodic 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 395(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 402

##### Exposures arising from mortgage lending

1. For the calculation of exposure values for the purposes of Article 395, 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 125(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 authorities of the Member States have not set a higher risk weight than 35 % for exposures or parts of exposures secured by residential real estate in accordance with Article 124(2);
- (b) the exposure or part of the exposure is fully secured by:
  - (i) mortgages on residential property; or
  - (ii) a residential property in a leasing transaction under which the lessor retains full ownership of the residential property and the lessee has not yet exercised his option to purchase;
- (c) the requirements in Article 208 and Article 229(1) are met.

2. For the calculation of exposure values for the purposes of Article 395, 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 126(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 authorities of the Member States have not set a higher risk weight than 50 % for exposures or parts of exposures secured by commercial real estate in accordance with Article 124(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 Article 126(2)(a), Article 208 and Article 229(1) are met;

(d) the commercial property is fully constructed.

3. An institution may treat an exposure to a counterparty that results from a reverse repurchase agreement under which the institution has purchased from the counterparty non-accessory independent mortgage liens on immovable property of third parties as a number of individual exposures to each of those third parties, provided that all of the following conditions are met:

(a) the counterparty is an institution;

(b) the exposure is fully secured by liens on the immovable property of those third parties that have been purchased by the institution and the institution is able to exercise those liens;

(c) the institution has ensured that the requirements in Article 208 and Article 229(1) are met;

(d) the institution becomes beneficiary of the claims that the counterparty has against the third parties in the event of default, insolvency or liquidation of the counterparty;

(e) the institution reports to the competent authorities in accordance with Article 394 the total amount of exposures to each other institution that are treated in accordance with this paragraph.

For these purposes, the institution shall assume that it has an exposure to each of those third parties for the amount of the claim that the counterparty has on the third party instead of the corresponding amount of the exposure to the counterparty. The remainder of the exposure to the counterparty, if any, shall continue to be treated as an exposure to the counterparty.

#### Article 403

##### 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 set out 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 92.

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 set out 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 set out 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 404

##### 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 405

**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 408 and deliver, in a timely manner, to the originator or sponsor and to the EU parent credit institution, EU financial holding company or EU mixed financial holding company the information needed to satisfy the requirements referred to in Article 409.

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 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.

## Article 406

**Due diligence**

1. Before becoming exposed to the risks 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 405(1), by originators, sponsors or original lenders 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 407

##### Additional risk weight

Where an institution does not meet the requirements in Article 405, 406 or 409 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 1 250 %) which shall apply to the relevant securitisation positions in the manner specified in Article 245(6) or Article 337(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 405(3) by reducing the risk weight it would otherwise impose under this Article in respect of a securitisation to which Article 405(3) applies.

#### TITLE III

##### REQUIREMENTS FOR SPONSOR AND ORIGINATOR INSTITUTIONS

#### Article 408

##### 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 79 of Directive 2013/36/EU 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 245(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 409

##### Disclosure to investors

Institutions acting as an originator, a sponsor or original lender shall disclose to investors the level of their commitment under Article 405 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 410***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 regulatory technical standards to specify in greater detail:

- (a) the requirements in Articles 405 and 406 applying to institutions becoming exposed to the risk of a securitisation;
- (b) the retention requirement, including the qualifying criteria for retaining a material net economic interest as referred to in Article 405 and the level of retention;
- (c) the due diligence requirements in Article 406 for institutions becoming exposed to a securitisation position; and
- (d) the requirements in Articles 408 and 409 applying to sponsor and originator institutions.

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

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

3. EBA shall develop draft implementing technical standards to facilitate the convergence of supervisory practices with regard to the implementation of Article 407, including the measures to be taken in the 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 Article 15 of Regulation (EU) No 1093/2010.

## PART SIX

**LIQUIDITY**

## TITLE I

**DEFINITIONS AND LIQUIDITY COVERAGE REQUIREMENT***Article 411***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 to Directive 2013/36/EU as its 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-financial holding company.

- (2) 'retail deposit' means a liability to a natural person or to an SME, where the natural person or the SME would qualify for the retail exposure class under the Standardised or IRB approaches for credit risk, or a liability to a company which is eligible for the treatment set out in Article 153(4) and where the aggregate deposits by all such enterprises on a group basis do not exceed EUR 1 million.

*Article 412***Liquidity coverage requirement**

1. Institutions shall hold liquid assets, the sum of the values of which covers 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 gravely stressed conditions over a period of thirty days. During times of stress, institutions may use their liquid assets to cover their net liquidity outflows.

2. Institutions shall not count double liquidity inflows and liquid assets.

3. Institutions may use the liquid assets referred to in paragraph 1 to meet their obligations under stressed circumstances as specified under Article 414.

4. The provisions set out in Title II shall apply exclusively for the purposes of specifying reporting obligations set out in Article 415.

5. Member States may maintain or introduce national provisions in the area of liquidity requirements before binding minimum standards for liquidity coverage requirements are specified and fully introduced in the Union in accordance with Article 460. Member States or competent authorities may require domestically authorised institutions, or a subset of those institutions, to maintain a higher liquidity coverage requirement up to 100 % until the binding minimum standard is fully introduced at a rate of 100 % in accordance with Article 460.

*Article 413***Stable Funding**

1. Institutions shall ensure that long term obligations are adequately met with a diversity of stable funding instruments under both normal and stressed conditions.

2. The provisions set out in Title III shall apply exclusively for the purposes of specifying reporting obligations set out in Article 415.

3. Member States may maintain or introduce national provisions in the area of stable funding requirements before binding minimum standards for net stable funding requirements are specified and introduced in the Union in accordance with Article 510.

*Article 414***Compliance with liquidity requirements**

Where an institution does not meet, or expects not to meet the requirement set out in Article 412 or the general obligation set out in Article 413(1), including during times of stress, it shall immediately notify the competent authorities and shall submit without undue delay to the competent authorities a plan for the timely restoration of compliance with Article 412 or Article 413(1). Until compliance has been restored, the institution shall report the items referred to in Title II or Title III, as appropriate, daily by the end of each business day unless the competent authority authorises a lower reporting frequency and a longer reporting delay. Competent authorities shall only grant such authorisations based on the individual situation of an institution and taking into account the scale and complexity of the institution's activities. They shall monitor the implementation of the restoration plan and shall require a more speedy restoration if appropriate.

## TITLE II

**LIQUIDITY REPORTING***Article 415***Reporting obligation and reporting format**

1. Institutions shall report in a single currency, regardless of their actual denomination, to the competent authorities the items referred to in Titles II and III and their components, including the composition of their liquid assets in accordance with Article 416. Until the liquidity coverage requirement in Part Six is fully specified and implemented as a minimum standard in accordance with Article 460, institutions shall report the items set in Title II and Annex III. Institutions shall report the items in Title III. The reporting frequency shall not be less than monthly for items referred to in Title II and Annex III and not less than quarterly for items referred to in Title III.

The reporting formats shall include all the necessary information and shall allow EBA to assess whether secured lending and collateral swap transactions where liquid assets

referred to in points (a), (b) and (c) of Article 416(1) have been obtained against collateral that does not qualify under points (a), (b) and (c) of Article 416(1) have been properly unwound.

2. An institution shall report separately to the competent authorities of the home Member State the items referred to in paragraph 1 in the currency below when it has:

- (a) aggregate liabilities in a currency different from the reporting currency under paragraph 1 amounting to or exceeding 5 % of the institution's or the single liquidity sub-group's total liabilities; or
- (b) a significant branch in accordance with Article 51 of Directive 2013/36/EU in a host Member State using a currency different from the reporting currency under paragraph 1 of this Article.

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

- (a) uniform formats and IT solutions with associated instructions for frequencies and reference and remittance dates. 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 in accordance with 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.

EBA shall submit to the Commission those draft implementing technical standards for the items specified in point (a) by 1 February 2015 and for the items specified in point (b) by 1 January 2014.

Until the full introduction of binding liquidity requirements, competent authorities may continue to collect information through monitoring tools for the purpose of monitoring compliance with existing national liquidity standards.

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



4. The competent authorities of the home Member State shall upon request provide in a timely manner and by electronic means the competent authorities and the central bank of the host Member States and EBA with the individual reporting in accordance with this Article.

5. Competent authorities that exercise supervision on a consolidated basis in accordance with Article 112 of Directive 2013/36/EU shall upon request provide in a timely manner and by electronic means the following authorities with all reporting submitted by the institution in accordance with the uniform reporting 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 in accordance with Article 51 of Directive 2013/36/EU 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 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 upon request provide in a timely manner and by electronic means the competent authorities that exercise supervision on a consolidated basis in accordance with Article 111 of Directive 2013/36/EU, the central bank of the Member State where the institution is authorised and EBA all reporting submitted by the institution in accordance with the uniform reporting formats referred to in paragraph 3.

#### Article 416

##### Reporting on liquid assets

1. Institutions shall report the following as liquid assets unless excluded by paragraph 2 and only if the liquid assets fulfil the conditions in paragraph 3:

- (a) cash and exposures to central banks to the extent that these exposures can be withdrawn at any time in times of stress. As regards deposits held with central banks, the competent authority and the central bank shall aim at reaching a common understanding regarding the extent to which minimum reserves can be withdrawn 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:

- (i) the central government of a Member State, a region with fiscal autonomy to raise and collect taxes, or of a third country in the domestic currency of the central or regional government, if the institution incurs a liquidity risk in that Member State or third country that it covers by holding those liquid assets;
- (ii) central banks and non-central government public sector entities in the domestic currency of the central bank and the public sector entity;
- (iii) the Bank for International Settlements, the International Monetary Fund, the Commission and multilateral development banks;
- (iv) the European Financial Stability Facility and the European Stability Mechanism;

(d) transferable assets that are of high liquidity and credit quality;

(e) standby credit facilities granted by central banks within the scope of monetary policy to the extent that these facilities are not collateralised by liquid assets and excluding emergency liquidity assistance;

(f) if the credit institution belongs to a network in accordance with legal or statutory provisions, the legal or statutory minimum deposits with the central credit institution and other statutory or contractually available liquid funding from the central credit institution or institutions that are members of the network referred to in Article 113(7), or eligible for the waiver provided in Article 10, to the extent that this funding is not collateralised by liquid assets.

Pending specification of a uniform definition in accordance with Article 460 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 specification of a uniform definition, competent authorities may, taking into account the criteria listed in Article 509(3), (4) and (5) 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 509(3), (4) and (5).

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 129(4) or (5) or asset backed instruments if demonstrated to be of the highest credit quality as established by EBA pursuant to the criteria in Article 509 (3), (4) and (5);

(ii) they are bonds as referred to in Article 52(4) of Directive 2009/65/EC other than those referred to in point (i) of this point;

(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; or at least 90 % of the loans granted by the institution are directly or indirectly 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 that are provided as collateral to the institution under reverse repo and securities financing transactions and that are held by the institution only as a credit risk mitigant and that are not legally and contractually available for use by the institution;

(c) 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 company;

(v) any other entity that performs one or more of the activities listed in Annex I to Directive 2013/36/EU as its main business.

3. In accordance with paragraph 1, institutions shall report assets that fulfil the following conditions as liquid assets:

(a) they are unencumbered or stand available within collateral pools to be used for the obtaining of additional funding under committed but not yet funded credit lines available to the institution;

(b) they are not issued by the institution itself or its parent or subsidiary institutions or another subsidiary of its parent institutions or parent financial holding company;

(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 eligible collateral for standard liquidity operations of a central bank in a Member State 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;

(e) they are listed on a recognised exchange or they are tradable on active outright sale or via a simple repurchase agreement on approved repurchase markets. These criteria shall be assessed separately for each market.

The conditions referred to in points (c), (d) and (e) of the first subparagraph shall not apply to the assets referred to in point (e) of paragraph 1.

The condition referred to in point (d) of the first subparagraph shall not apply in the 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 the 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 the same or an equivalent exception.

4. Notwithstanding the provisions of paragraphs 1, 2 and 3, pending the specification of a binding liquidity requirement in accordance with Article 460 and in accordance with the second subparagraph of paragraph 1 of this Article, institutions shall report on:

(a) other non-central bank eligible but tradable assets such as equities and gold based on transparent and objective criteria, including some or all of the criteria listed in Article 509(3), (4) and (5);

(b) other central bank eligible and tradable assets such as asset backed instruments of the highest credit quality as established by EBA pursuant to the criteria in Article 509(3), (4) and (5);

(c) other central bank eligible but non-tradable assets such as credit claims as established by EBA pursuant to the criteria in Article 509(3), (4) and (5).

5. EBA shall develop draft implementing technical standards listing the currencies which meet the conditions referred to in the third subparagraph of paragraph 3.

EBA shall submit those draft implementing technical standards to the Commission by 31 March 2014.

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

Before the entry into force of the technical standards referred to in the third 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 2014.

6. Shares or units in CIUs may be treated as liquid assets up to an absolute amount of EUR 500 million in the portfolio of liquid assets of each institution provided that the requirements in Article 132(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 referred to in paragraph 1 of this Article.

The use or potential use by a CIU of derivative instruments to hedge risks of permitted investments shall not prevent that CIU from being eligible. Where the value of the shares or units of the CIU is not regularly marked to market by the third parties referred to in points (a) and (b) of Article 418(4) and the competent authority is not satisfied that an institution has developed robust methodologies and processes for such valuation as referred to in the first sentence of Article 418(4), shares or units in that CIU shall not be treated as liquid assets.

7. Where a liquid asset ceases to be eligible in the stock of liquid assets, an institution may nevertheless continue to consider it a liquid asset for an additional period of 30 calendar days. Where a liquid asset in a CIU ceases to be eligible for the treatment set out in paragraph 6, the shares or units in the CIU may nevertheless be considered a liquid asset for an additional period of 30 days provided that those assets do not exceed 10 % of the CIU's overall assets.

#### Article 417

##### 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. Diversification is not required in terms of assets corresponding to points (a), (b) and (c) of Article 416(1);
- (b) they are legally and practically readily available at any time during the next 30 days to be liquidated via outright sale or via a simple repurchase agreement on approved repurchase markets in order to meet obligations coming due. Liquid assets referred to in point (c) of Article 416(1) 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, unless the institution can demonstrate to the competent authorities that it has appropriately hedged the ensuing currency risk;
- (c) the liquid assets are controlled by a liquidity management function;
- (d) a portion of the liquid assets except those referred to in points (a), (c) and (e) of Article 416(1) is periodically and at least annually liquidated via outright sale or via simple repurchase agreements on an approved repurchase market 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;
- (e) price risks associated with the assets may be hedged but the liquid assets are subject to appropriate internal arrangements that ensure that they are readily available to the treasury when needed and especially that they are not used in other ongoing operations, including:
  - (i) hedging or other trading strategies;
  - (ii) providing credit enhancements in structured transactions;
  - (iii) covering operational costs.
- (f) the denomination of the liquid assets is consistent with the distribution by currency of liquidity outflows after the deduction of inflows.

*Article 418***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 referred to in point (d) of Article 416(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 416(6) shall be subject to haircuts, looking through to the underlying assets as follows:

- (a) 0 % for the assets referred to in point (a) of Article 416(1);
- (b) 5 % for the assets referred to in points (b) and (c) of Article 416(1);
- (c) 20 % for the assets referred to in point (d) of Article 416(1).

3. The look-through approach referred to in paragraph 2 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 points (a) to (d) of Article 416(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 416(1) until the maximum total investment limit is reached.

4. Institutions shall develop robust methodologies and processes to calculate and report the market value and haircuts for shares or units in CIUs. Only where they can demonstrate to the satisfaction of the competent authority that the materiality of the exposure does not justify the development of their own methodologies, 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) of paragraph 3:

- (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 132(3)(a).

The correctness of the calculations by the depository institution or the CIU management company shall be confirmed by an external auditor.

*Article 419***Currencies with constraints on the availability of liquid assets**

1. EBA shall assess the availability for institutions of the liquid assets referred to in point (b) of Article 416(1) in the currencies that are relevant for institutions established in the Union.

2. Where the justified needs for liquid assets in light of the requirement in Article 412 are exceeding the availability of those liquid assets in a currency, one or more of the following derogations shall apply:

(a) by way of derogation from point (f) of Article 417, the denomination of the liquid assets may be inconsistent with the distribution by currency of liquidity outflows after the deduction of inflows;

(b) for currencies of a Member State or third countries, required liquid assets may be substituted by credit lines from the central bank of that Member State or third country, which are contractually irrevocably committed for the next 30 days and are fairly priced, independent of the amount currently drawn, provided that the competent authorities of that Member State or third country do the same and that Member State or third country has comparable reporting requirements in place.

3. The derogations applied in accordance with paragraph 2 shall be inversely proportional to the availability of the relevant assets. The justified needs of institutions shall be assessed taking into account their ability to reduce, by sound liquidity management, the need for those liquid assets and the holdings of those assets by other market participants.

4. EBA shall develop draft implementing technical standards listing the currencies which meet the conditions set out in this Article.

EBA shall submit those draft implementing technical standards to the Commission by 31 March 2014.

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

5. EBA shall develop draft regulatory technical standards to specify the derogations referred to in paragraph 2 including the conditions of their application.

EBA shall submit those draft regulatory technical standards to the Commission by 31 March 2014.

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

#### Article 420

##### Liquidity outflows

1. Pending the specification of a liquidity requirement in accordance with Article 460, liquidity outflows to be reported shall include:

- (a) the current amount outstanding for retail deposits as set out in Article 421;
- (b) the current amounts outstanding of other liabilities that come due, can be called for payout by the issuing institutions 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 422;
- (c) the additional outflows referred to in Article 423;
- (d) the maximum amount that can be drawn during the next 30 days from undrawn committed credit and liquidity facilities, as set out in Article 424;
- (e) the additional outflows identified in the assessment in accordance with 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 422, 423 and 424 and which they offer or sponsor or which potential purchasers would consider to be associated with them, including but not limited to liquidity outflows resulting from any contractual arrangements such as other off-balance sheet and contingent funding obligations, including, but not limited to committed funding facilities, un-drawn loans and advances to wholesale counterparties, mortgages that have been agreed but not yet drawn down, credit cards, overdrafts, planned outflows related to renewal or extension of new retail or wholesale loans, planned derivative payables and trade finance off-balance sheet related products, as referred to in Article 429 and in Annex I. 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 damage that could result from not providing liquidity support to such products or services. Institutions shall report not less than annually to the competent authorities those products and services for which the likelihood and potential volume of the liquidity outflows referred to in the first subparagraph are material and the competent authorities shall determine the outflows to be assigned. The competent authorities may apply an outflow rate up to 5 % for trade finance off-balance sheet related products, as referred to in Article 429 and Annex I.

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 that report also explain the methodology applied to determine the outflows.

#### Article 421

##### Outflows on retail deposits

1. Institutions shall separately report the amount of retail deposits covered by a Deposit Guarantee Scheme in accordance with Directive 94/19/EC or an equivalent deposit guarantee scheme in a third country, and multiply by at least 5 % where the deposit is either of the following:

- (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 competent authorities, EBA shall issue guidelines by 1 January 2014 on the criteria to determine the conditions of application of paragraphs 1 and 2 in relation to the identification of retail deposits subject to different outflows and the definitions of those products for purposes of this Title. Those 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. Notwithstanding paragraphs 1 and 2, institutions shall multiply retail deposits that they have taken in third countries by a higher percentage than provided for in those paragraphs 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; or
- (b) for early withdrawals within 30 days, the depositor has to pay a penalty that includes the loss of interest 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 422

##### 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 point (3) of Article 192 by:

- (a) 0 % up to the value of the liquid assets in accordance with Article 418 if they are collateralised by assets that would qualify as liquid assets in accordance with Article 416;
- (b) 100 % over the value of the liquid assets in accordance with Article 418, if they are collateralized by assets that would qualify as liquid assets in accordance with Article 416;
- (c) 100 % if they are collateralized by assets that would not qualify as liquid assets in accordance with Article 416, with the exception of transactions covered by points (d) and (e) of this paragraph;
- (d) 25 % if they are collateralized by assets that would not qualify as liquid assets in accordance with Article 416 and the lender is the central government, a public sector entity of the Member State in which the credit institution has been authorised or has established a branch, or a multilateral development bank. Public sector entities that receive that treatment shall be limited to those that have a risk weight of 20 % or lower in accordance with Chapter 2, Title II of Part Three;
- (e) 0 % if the lender is a central bank.

3. 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 or other comparable services from the institution;
- (b) in the context of common task sharing within an institutional protection scheme meeting the requirements of Article 113(7) or as a legal or statutory minimum deposit by another entity being a Member of the same institutional protection scheme;
- (c) by the depositor in the context of an established operational relationship other than that mentioned in point (a);
- (d) by the depositor to obtain cash clearing and central credit institution services and where the credit institution belongs to a network in accordance with legal or statutory provisions;

by 5 % in the case of point (a) to the extent to which they are covered by a Deposit Guarantee Scheme in accordance with Directive 94/19/EC or an equivalent deposit guarantee scheme in a third country and by 25 % otherwise.

Deposits from credit institutions placed at central credit institutions that are considered as liquid assets in accordance with Article 416(1)(f) shall be multiplied by 100 % outflow rate.

4. Clearing, custody or cash management or other comparable services referred to in points (a) and (d) of paragraph 3 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 merely 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 operational relationship as referred to in point (c) of paragraph 3, institutions shall themselves establish the criteria to identify an established operational relationship for which they have evidence that the client is unable to withdraw amounts legally due over a 30 day horizon without compromising their 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 to the extent they do not fall under paragraphs 3 and 4 by 40 % and shall multiply the amount of these liabilities covered by a Deposit Guarantee Scheme in accordance with Directive 94/19/EC or an equivalent Deposit Guarantee Scheme in a third country by 20 %.

6. Institutions shall take outflows and inflows 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 the case of a net outflow. Net basis shall mean also net of collateral to be received that qualifies as liquid assets under Article 416.

7. Institutions shall separately report other liabilities that do not fall under paragraphs 1 to 5.

8. Competent authorities may grant the permission to apply a lower outflow percentage on a case-by-case basis, to the liabilities referred to in paragraph 7, when all of the following conditions are fulfilled:

- (a) the depositor is:
- (i) a parent or subsidiary institution of the institution or another subsidiary of the same parent institution;
  - (ii) linked to the institution by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC;
  - (iii) an institution falling within the same institutional protection scheme meeting the requirements of Article 113(7);
  - (iv) the central institution or a member of a network compliant with Article 400 (2)(d);
- (b) there are reasons to expect a lower outflow over the next 30 days even under a combined idiosyncratic and market-wide stress scenario;
- (c) a corresponding symmetric or more conservative inflow is applied by the depositor by way of derogation from Article 425;
- (d) the institution and the depositor are established in the same Member State.

9. Competent authorities may waive the conditions set out in point (d) of paragraph 8 where point (b) of Article 20(1) is applied. In that case additional objective criteria as set out in the delegated act referred to in Article 460 have to be met. Where such lower outflow is permitted to be applied, the competent authorities shall inform EBA about the result of the process referred to in point (b) of Article 20(1). The fulfilment of the

conditions for such lower outflows shall be regularly reviewed by the competent authorities.

10. EBA shall develop draft regulatory technical standards to further specify the additional objective criteria referred to in paragraph 9.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2015.

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

#### Article 423

#### Additional Outflows

1. Collateral other than assets referred to in Article 416(1)(a), (b) and (c), which is posted by the institution for contracts listed in Annex II and credit derivatives, shall be subject to an additional outflow of 20 %.

2. Institutions shall notify to the competent authorities all contracts entered into the contractual conditions of which lead, within 30 days following a material deterioration of the credit quality of the institution, to liquidity outflows or additional collateral needs. If the competent authorities consider such contracts material in relation to the potential liquidity outflows of the institution, they shall require the institution to add an additional outflow for those contracts 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 authorities.

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 31 March 2014.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the second subparagraph in accordance with 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.

5. The institution shall add an additional outflow corresponding to:

- (a) the excess collateral the institution holds that can be contractually called at any time by the counterparty;
- (b) collateral that is due to be returned to a counterparty;
- (c) collateral that corresponds to assets that would qualify as liquid assets for the purposes of Article 416 that can be substituted for assets corresponding to assets that would not qualify as liquid assets for the purposes of Article 416 without the consent of the institution.

6. Deposits received as collateral shall not be considered liabilities for the purposes of Article 422 but will be subject to the provisions of this Article where applicable.

#### Article 424

##### Outflows from credit and liquidity facilities

1. Institutions shall report outflows from committed credit facilities and committed liquidity facilities, which shall be determined as a percentage of the maximum amount that can be drawn within the next 30 days. This maximum amount that can be drawn may be assessed net of any liquidity requirement that would be mandated under Article 420(2) for the trade finance off-balance sheet items and net of the value in accordance with Article 418 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 416. 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 drawdown schedule coming due over the next 30 days.

2. The maximum amount that can be drawn of undrawn committed credit facilities and undrawn committed liquidity facilities within the next 30 days 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 facilities and undrawn committed liquidity facilities within the next 30 days 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.

4. The committed amount of a liquidity facility that has been provided to an SSPE for the purpose of enabling such an 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.

5. The institutions shall report the maximum amount that can be drawn of other undrawn committed credit facilities and undrawn committed liquidity facilities within the next 30 days. This applies in particular to the following:

- (a) liquidity facilities that the institution has granted to SSPEs other than those referred to in point (b) of paragraph 3;
- (b) arrangements under which the institution is required to buy or swap assets from an SSPE;
- (c) facilities extended to credit institutions;
- (d) facilities extended to financial institutions and investment firms.

6. By way of derogation from paragraph 5, institutions which have been set up and are sponsored by at least one Member State's central or regional government may apply the treatments set out in paragraphs 2 and 3 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. By way of derogation from point (d) of Article 425(2), where those promotional loans are extended via another institution as intermediary (pass through loans), a symmetric in and outflow may be applied by institutions. 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 the Union and/or that Member State's central or regional government. It shall only be possible to draw on such facilities following the reasonably expected demand for a promotional loan and up to the amount of such demand linked to a subsequent reporting on the use of the funds disbursed.

#### Article 425

##### Inflows

1. Institutions shall report their liquidity inflows. Capped liquidity inflows shall be the liquidity inflows limited to 75 % of liquidity outflows. Institutions may exempt liquidity inflows from deposits placed with other institutions and qualifying for the treatments set out in Article 113(6) or (7) from this limit. Institutions may exempt liquidity inflows from monies due from borrowers and bond investors related to mortgage lending funded by bonds eligible for the treatment set out in Article 129(4), (5) or (6) or by bonds as referred to in Article 52(4) of Directive 2009/65/EC from this limit. Institutions may exempt inflows from promotional loans that the institutions have passed through. Subject to the prior approval of the competent authority responsible for supervision on an individual basis, the institution may fully or partially exempt inflows where the provider is a parent or a 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.

2. The liquidity inflows shall be measured over the next 30 days. They shall comprise only 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. Liquidity inflows shall be reported in full with the following inflows reported separately:

(a) monies due from customers that are not 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 point (3) of Article 192 that are collateralised by liquid assets in accordance with Article 416 as referred to in point (d) of this paragraph.

By way of derogation from the first subparagraph of this point, institutions that have received a commitment referred to in Article 424(6) 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;

- (b) monies due from trade financing transactions referred to in point (b) of the second subparagraph of Article 162(3) with a residual maturity of up to 30 days, shall be taken into account in full as inflows;
- (c) assets with an undefined contractual end date shall be taken into account with a 20 % inflow provided that the contract allows the bank to withdraw and request payment within 30 days;
- (d) monies due from secured lending and capital market-driven transactions as defined in point (3) of Article 192 if they are collateralised by liquid assets as referred to in Article 416(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;
- (e) monies due that the institution owing those monies treats in accordance with Article 422(3) and (4), shall be multiplied by a corresponding symmetrical inflow;
- (f) monies due from positions in major index equity instruments provided there is no double counting with liquid assets;
- (g) any undrawn credit or liquidity facilities and any other commitments received shall not be taken into account.

3. Outflows and inflows 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 % in the event of a net inflow. Net basis shall mean also net of collateral to be received that qualifies as liquid assets under Article 416.

4. By way of derogation from point (g) of paragraph 2, competent authorities may grant the permission to apply a higher inflow on a case by case basis for credit and liquidity facilities 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 113(7) of this Regulation or the central institution or a member of a network that is subject to the waiver referred to in Article 10 of this Regulation;

(c) a corresponding symmetric or more conservative outflow is applied by the counterparty by way of derogation from Articles 422, 423 and 424;

(d) the institution and the counterparty are established in the same Member State.

5. Competent authorities may waive the condition set out in point (d) of paragraph 4 where Article 20(1)(b) is applied. In that case additional objective criteria as set out in the delegated act referred to in Article 460 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 20(1)(b). Fulfilment of the conditions for such higher inflows shall be regularly reviewed by the competent authorities.

6. EBA shall develop draft regulatory technical standards to further specify the additional objective criteria referred to in paragraph 5.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2015.

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

7. Institutions shall not report inflows from any of the liquid assets reported in accordance with Article 416 other than payments due on the assets that are not reflected in the market value of the asset.

8. Institutions shall not report inflows from any new obligations entered into.

9. 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 respectively in the third country or currency in question.

#### Article 426

##### Updating Future liquidity requirements

Following the adoption by the Commission of a delegated act to specify the liquidity requirement in accordance with Article 460, EBA may develop draft implementing technical standards to specify the conditions set out in Article 421(1), Article 422, with the exception of paragraphs 8, 9 and 10 of that Article, and Article 424 to take account of standards agreed internationally.

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

#### TITLE III

##### REPORTING ON STABLE FUNDING

#### Article 427

##### Items providing stable funding

1. Institutions shall report to the competent authorities, in accordance with the reporting requirements set out in Article 415(1) and the uniform reporting formats referred to in Article 415(3), the following items and their components in order to allow an assessment of the availability of stable funding:

(a) the following own funds, after deductions have been applied, where appropriate:

(i) tier 1 capital instruments;

(ii) tier 2 capital instruments;

(iii) other preferred shares and capital instruments in excess of Tier 2 allowable amount having an effective maturity of one year or greater;

(b) the following liabilities not included in point (a):

(i) retail deposits that qualify for the treatment set out in Article 421(1);

(ii) retail deposits that qualify for the treatment set out in Article 421(2);

(iii) deposits that qualify for the treatment set out in Article 422 (3) and (4);

(iv) of the deposits referred to in point (iii), those that are subject to a deposit guarantee scheme in accordance with Directive 94/19/EC or an equivalent deposit guarantee scheme in a third country deposit guarantees within the terms of Article 421(2);



- (v) of the deposits referred to in point (iii), those that fall under point (b) of Article 422(3);
- (vi) of the deposits referred to in point (iii), those that fall under point (d) of Article 422(3);
- (vii) amounts deposited not falling under point (i), (ii) or (iii) if they are not deposited by financial customers;
- (viii) all funding obtained from financial customers;
- (ix) separately for amounts falling under points (vii) and (viii) respectively, funding from secured lending and capital market-driven transactions as defined in point (3) of Article 192:
- collateralised by assets that would qualify as liquid assets in accordance with Article 416;
  - collateralised by any other assets;
- (x) liabilities resulting from securities issued qualifying for the treatment set out in Article 129(4) or (5) or as referred to in Article 52(4) of Directive 2009/65/EC;
- (xi) the following other liabilities resulting from securities issued that do not fall under point (a):
- liabilities resulting from securities issued with an effective maturity of one year or greater;
  - liabilities resulting from securities issued with an effective maturity of less than one year;
- (xii) any other liabilities.
2. Where applicable, all items shall be presented in the following five buckets according to the closest of their maturity date and the earliest date at which they can contractually be called:
- (a) within three months;
- (b) between three and six months;
- (c) between six and nine months;
- (d) between nine and 12 months;
- (e) after 12 months.
- (b) the following securities and money market instruments not included in point (a):
- (i) assets qualifying for credit step 1 under Article 122;
  - (ii) assets qualifying for credit step 2 under Article 122;
  - (iii) other assets;
- (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 separately those non-renewable loans and receivables for which borrowers are:
- (i) natural persons other than commercial sole proprietors and partnerships;
  - (ii) SMEs that qualify for the retail exposure class under the Standardised or IRB approaches for credit risk or to a company which is eligible for the treatment set out in Article 153(4) and where the aggregate deposit placed by that client or group of connected clients is less than EUR 1 million;
  - (iii) sovereigns, central banks and public sector entities;
  - (iv) clients not referred to in points (i) and (ii) other than financial customers;
  - (v) clients not referred to in points (i), (ii) and (iii) that are financial customers, and thereof separately those that are credit institutions and other financial customers;
- (h) non-renewable loans and receivables referred to in point (g), and thereof separately those that are:
- (i) collateralised by commercial real estate (CRE);
  - (ii) collateralised by residential real estate (RRE);
  - (iii) match funded (pass-through) via bonds eligible for the treatment set out in Article 129(4) or (5) or via bonds as referred to in Article 52(4) of Directive 2009/65/EC;

#### Article 428

##### 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 that would qualify as liquid assets in accordance with Article 416, broken down by asset type;
- (i) derivatives receivables;
- (j) any other assets;
- (k) undrawn committed 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 427(2).

## PART SEVEN

### LEVERAGE

#### Article 429

#### Calculation of the leverage ratio

1. Institutions shall calculate their leverage ratio in accordance with the methodology set out in paragraphs 2 to 11.

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.

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 a financial sector entity in which they hold a significant investment in accordance with Article 43 in their consolidation according to the applicable accounting framework, but not in their prudential consolidation in accordance with Chapter 2 of Title II of Part One, they shall determine the exposure value for the significant investment not in accordance with point (a) of paragraph 5 of this Article but as the amount that is obtained by multiplying the amount defined in point (a) of this subparagraph with the factor defined in point (b) of this subparagraph:

- (a) the sum of the exposure values of all exposures of the financial sector entity in which the significant investment is held;
- (b) for all direct, indirect and synthetic holdings of the institution of the Common Equity Tier 1 instruments of the financial sector entity, the total amount of such items not deducted pursuant to Article 47 and point (b) of Article 48(1) divided by the total amount of such items.

5. Institutions shall determine the exposure value of assets in accordance with the following principles:

(a) the exposure values of assets excluding contracts listed in Annex II and credit derivatives, means exposure values in accordance with the first sentence of Article 111(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. Institutions shall determine the exposure value of contracts listed in Annex II and of credit derivatives including those that are off-balance sheet, in accordance with the method set out in Article 274.

In determining the exposure value of contracts listed in Annex II and of credit derivatives, 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 295.

7. By way of derogation from paragraph 6, institutions may use the method set out in Article 275 to determine the exposure value of contracts listed in points 1 and 2 of Annex II only where they also use that method for determining the exposure value of those contracts for the purposes of meeting the own funds requirements set out in Article 92.

8. When determining the potential future credit exposure of credit derivatives, institutions shall apply the principles laid down in Article 299(2) to all their credit derivatives, not just those assigned to the trading book.

9. Institutions shall determine the exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions including those that are off-balance sheet, in accordance with Article 220(1) to (3) and Article 222, and shall take into account the effects of master netting agreements, except contractual cross-product netting agreements, in accordance with Article 206.

10. Institutions shall determine the exposure value of off-balance sheet items, except the items referred to in paragraphs 6 and 9 of this Article, in accordance with Article 111(1), subject to the following amendments to the conversion factors listed in that Article:

- (a) the conversion factor to be applied to the nominal value for undrawn credit facilities, which may be cancelled unconditionally at any time without notice, referred to in points 4(a) and (b) of Annex I, is 10 %;

(b) the conversion factor for medium/low risk trade finance related off-balance sheet items referred to in point 3(a) of Annex I and to officially supported export credits related off-balance sheet items referred to in point 3(b)(i) of Annex I is 20 %;

(c) the conversion factor for medium risk trade finance related off-balance sheet items referred to in points 2(a) and 2(b)(i) of Annex I and to officially supported export credits related off-balance sheet items referred to in point 2(b)(ii) of Annex I is 50 %;

(d) the conversion factor for all other off-balance sheet items listed in Annex I is 100 %.

11. Where national generally accepted accounting principles recognises fiduciary assets on balance sheet, in accordance with Article 10 of Directive 86/635/EEC, those assets may be excluded from the leverage ratio total exposure measure provided that they meet the criteria for non-recognition set out in International Accounting Standard (IAS) 39, as applicable under Regulation (EC) No 1606/2002, and, where applicable, the criteria for non-consolidation set out in International Financial Reporting Standard (IFRS) 10, as applicable under Regulation (EC) No 1606/2002.

#### Article 430

##### Reporting requirement

1. Institutions shall submit to the competent authorities all necessary information on the leverage ratio and its components in accordance with Article 429. Competent authorities shall take into account this information when undertaking the supervisory review referred to in Article 97 of Directive 2013/36/EU.

Institutions shall also submit to the competent authorities the information required for the purposes of the preparation of the reports referred to in Article 511.

Competent authorities shall submit the information received from institutions to EBA upon its request to facilitate the review referred to in Article 511.

2. EBA shall develop draft implementing technical standards to determine the uniform reporting 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 February 2015.

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

## PART EIGHT

### DISCLOSURE BY INSTITUTIONS

#### TITLE I

#### GENERAL PRINCIPLES

##### Article 431

##### Scope of disclosure requirements

1. Institutions shall publicly disclose the information laid down in Title II, subject to the provisions laid down in Article 432.

2. Permission granted by the competent authorities under Part Three for 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 432.

4. Institutions shall, if requested, explain their rating decisions to SMEs 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 432

##### 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 435(2)(c), Article 437 and Article 450.

Information in disclosures shall be regarded as material 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.

EBA shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines by 31 December 2014 on how institutions have to apply materiality in relation to the disclosure requirements of Title II.

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 Articles 437 and 450.

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.

EBA shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines by 31 December 2014 on how institutions have to apply proprietary and confidentiality in relation to the disclosure requirements of Titles II and III.

3. In the exceptional 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.

4. Paragraphs 1, 2 and 3 are without prejudice to the scope of liability for failure to disclose material information.

#### *Article 433*

##### **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 437, and points (c) to (f) of Article 438, and information on risk exposure and other items prone to rapid change.

EBA shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines by 31 December 2014 on institutions assessing more frequent disclosures of Titles II and III.

#### *Article 434*

##### **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 media, a reference to the synonymous information in the other media shall be included within each medium.

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 435*

##### **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 the 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 comprehensive view of the institution's management of risk, including how the 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) the policy on diversity with regard to selection of members of the management body, its 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 436

##### Scope of application

Institutions shall disclose the following information regarding the scope of application of the requirements of this Regulation in accordance with Directive 2013/36/EU:

- (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 circumstance of making use of the provisions laid down in Articles 7 and 9.

#### Article 437

##### 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 32 to 35, 36, 56, 66 and 79 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 32 to 35;
  - (ii) each deduction made pursuant to Articles 36, 56 and 66;
  - (iii) items not deducted in accordance with Articles 47, 48, 56, 66 and 79;
- (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), (d) and (e) of paragraph 1.

EBA shall submit those draft implementing technical standards to the Commission by 1 February 2015.



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

#### Article 438

##### Capital requirements

Institutions shall disclose the following information regarding the compliance by the institution with the requirements laid down in Article 92 of this Regulation and in Article 73 of Directive 2013/36/EU:

- (a) a summary of the institution's approach to assessing the adequacy of its internal capital to support current and future activities;
- (b) upon demand from the relevant competent authority, the result of the institution's internal capital adequacy assessment process including the composition of the additional own funds requirements based on the supervisory review process as referred to in point (a) of Article 104(1) of Directive 2013/36/EU;
- (c) 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 112;
- (d) 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 147. For the retail exposure class, this requirement applies to each of the categories of exposures to which the different correlations in Article 154(1) to (4) correspond. For the equity exposure class, this requirement applies to:
  - (i) each of the approaches provided in Article 155;
  - (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;
- (e) own funds requirements calculated in accordance with points (b) and (c) of Article 92(3);
- (f) own funds requirements calculated in accordance with Part Three, Title III, Chapters 2, 3 and 4 and disclosed separately.

The institutions calculating the risk-weighted exposure amounts in accordance with Article 153(5) or Article 155(2) shall

disclose the exposures assigned to each category in Table 1 of Article 153(5), or to each risk weight mentioned in Article 155(2).

#### Article 439

##### Exposure to counterparty credit risk

Institutions shall disclose the following information regarding the institution's exposure to counterparty credit risk as referred to in Part Three, Title II, 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 Part Three, Title II, Chapter 6, Sections 3 to 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 440

##### 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 2013/36/EU:

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

#### Article 441

##### Indicators of global systemic importance

1. Institutions identified as G-SIIs in accordance with Article 131 of Directive 2013/36/EU shall disclose, on an annual basis, the values of the indicators used for determining the score of the institutions in accordance with the identification methodology referred to in that Article.

2. EBA shall develop draft implementing technical standards to specify the uniform formats and date for the purposes of the disclosure referred to in paragraph 1. In developing those technical standards, EBA shall take into account international standards.

EBA shall submit those draft implementing technical standards to the Commission by 1 July 2014.

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

#### Article 442

##### 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, including specifying exposure to SMEs, 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 443

##### Unencumbered assets

EBA shall issue guidelines specifying the disclosure of unencumbered assets, taking into account Recommendation ESRB/2012/2 of the European Systemic Risk Board of 20 December 2012 on funding of credit institutions<sup>(1)</sup> and in particular Recommendation D - Market transparency on asset encumbrance, by 30 June 2014. Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.

<sup>(1)</sup> OJ C 119, 25.4.2013, p. 1.

EBA shall develop draft regulatory technical standards to specify disclosure of the balance sheet value per exposure class broken down by asset quality and the total amount of the balance sheet value that is unencumbered, taking into account Recommendation ESRB/2012/2 and conditional on EBA considering in its report that such additional disclosure offers reliable and meaningful information.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2016.

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

#### Article 444

##### 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 112:

- (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 445

##### Exposure to market risk

The institutions calculating their own funds requirements in accordance with points (b) and (c) of Article 92(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 446

##### 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 312(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 447

##### 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 448

##### 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 449

**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 337 or 338 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 Internal Assessment Approach 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 1 250 %;
- (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 248(1) and the impact on own funds.
- 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, as well as the number of meetings held by the main body overseeing remuneration during the financial year, 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) the ratios between fixed and variable remuneration set in accordance with Article 94(1)(g) of Directive 2013/36/EU;
- (e) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;
- (f) the main parameters and rationale for any variable component scheme and any other non-cash benefits;
- (g) aggregate quantitative information on remuneration, broken down by business area;
- (h) 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;

#### Article 450

#### Remuneration policy

1. Institutions shall disclose at least the following information, regarding the remuneration policy and practices



- (vi) the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person;
- (i) 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;
- (j) upon demand from the Member State or competent authority, the total remuneration for each member of the management body or senior management.
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 members of the management body of the institution.

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 451

##### Leverage

1. Institutions shall disclose the following information regarding their leverage ratio calculated in accordance with Article 429 and their management of the risk of excessive leverage:
- (a) the leverage ratio and how the institution applies Article 499(2) and (3);
- (b) a breakdown of the total exposure measure as well as a reconciliation of the total exposure measure with the relevant information disclosed in published financial statements;
- (c) where applicable, the amount of derecognised fiduciary items in accordance with Article 429(11);
- (d) a description of the processes used to manage the risk of excessive leverage;
- (e) 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 Article 15 of Regulation (EU) No 1093/2010.

#### TITLE III

### QUALIFYING REQUIREMENTS FOR THE USE OF PARTICULAR INSTRUMENTS OR METHODOLOGIES

#### Article 452

##### 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 154(1) to (4) correspond;
- (v) equities;
- (d) the exposure values for each of the exposure classes specified in Article 147. 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 set out in point (c)(iv), either the disclosures outlined in point (e) (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 set out in 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 set out in 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 set out in 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 set out in this Article;
- (j) for all exposure classes specified in Article 147 and for each category of exposure to which the different correlations in Article 154 (1) to (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 178, 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 453

#### 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 155.
- (c) a description of the extent and methodologies for compliance with the requirements set out in Articles 104 and 105;
  - (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;

#### Article 454

### Use of the Advanced Measurement Approaches to operational risk

The institutions using the Advanced Measurement Approaches set out in Articles 321 to 324 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 455

### Use of Internal Market Risk Models

Institutions calculating their capital requirements in accordance with Article 363 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;
- (e) the elements of the own funds requirement as specified in Article 364;
- (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 456

#### Delegated acts

1. The Commission shall be empowered to adopt delegated acts in accordance with Article 462, concerning the following matters:
  - (a) clarification of the definitions set out in Articles 4, 5, 142, 153, 192, 242, 272, 300, 381 and 411 to ensure uniform application of this Regulation;
  - (b) clarification of the definitions set out in Articles 4, 5, 142, 153, 192, 242, 272, 300, 381 and 411 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 112 and 147 in order to take account of developments on financial markets;
  - (d) the amount specified in point (c) of Article 123, Article 147(5)(a), Article 153(4) and Article 162(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 95(1) and Article 96(1) to take account of developments on financial markets;
- (g) clarification of the requirement laid down in Article 97 to ensure uniform application of this Regulation.
- (h) amendment of the own funds requirements as set out in Articles 301 to 311 of this Regulation and Articles 50a to 50d of Regulation (EU) No 648/2012 to take account of developments or amendments of the international standards for exposures to a central counterparty;
- (i) clarification of the terms referred to in the exemptions provided for in Article 400;
- (j) amendment of the capital measure and the total exposure measure of the leverage ratio referred to in Article 429(2) in order to correct any shortcomings discovered on the basis of the reporting referred to in Article 430(1) before the leverage ratio has to be published by institutions as set out in Article 451(1)(a).

2. EBA shall monitor the own fund requirements for credit valuation adjustment risk and by 1 January 2015 submit a report to the Commission. In particular, the report shall assess:

- (a) the treatment of CVA risk as a stand-alone charge versus an integrated component of the market risk framework;
- (b) the scope of the CVA risk charge including the exemption in Article 482;
- (c) eligible hedges;
- (d) calculation of capital requirements of CVA risk.

On the basis of that report and where the findings are that such action is necessary the Commission shall also be empowered to adopt a delegated act in accordance with Article 462 to amend Article 381, Article 382(1) to (3) and Articles 383 to 386 concerning those items.

#### Article 457

##### Technical adjustments and corrections

The Commission shall be empowered to adopt delegated acts in accordance with Article 462, to make technical adjustment and corrections of non-essential elements in the following provisions in order to take account of developments in new financial products or activities, to make adjustments taking into account developments after the adoption of this Regulation in

other legislative acts of the Union on financial services and accounting including accounting standards based on Regulation (EC) No 1606/2002:

- (a) the own funds requirements for credit risk laid down in Articles 111 to 134, and in Articles 143 to 191;
- (b) the effects of credit risk mitigation in accordance with Articles 193 to 241;
- (c) the own funds requirements for securitisation laid down in Articles 243 to 266;
- (d) the own funds requirements for counterparty credit risks in accordance with Articles 272 to 311;
- (e) the own funds requirements for operational risk laid down in Articles 315 to 324;
- (f) the own funds requirements for market risk laid down in Articles 325 to 377;
- (g) the own funds requirements for settlement risk laid down in Articles 378 and 379;
- (h) the own funds requirements for credit valuation adjustment risk laid down in Articles 383, 384 and 386;
- (i) Part Two and Article 99 only as a result of developments in accounting standards or requirements which take account of Union legislation.

#### Article 458

##### Macroprudential or systemic risk identified at the level of a Member State

1. Member States shall designate the authority in charge of the application of this Article. This authority shall be the competent authority or the designated authority.

2. Where the authority determined in accordance with paragraph 1 identifies changes in the intensity of macroprudential or systemic risk 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 and which that authority considers would better be addressed by means of stricter national measures, it shall notify the European Parliament, the Council, the Commission, the ESRB and EBA of that fact and submit relevant quantitative or qualitative evidence of all of the following:

- (a) the changes in the intensity of macroprudential or systemic risk;
- (b) the reasons why such changes could pose a threat to financial stability at national level;

- (c) a justification of why Articles 124 and 164 of this Regulation and Articles 101, 103, 104, 105, 133, and 136 of Directive 2013/36/EU cannot adequately address the macroprudential or systemic risk identified, taking into account the relative effectiveness of those measures;
- (d) draft national measures for domestically authorised institutions, or a subset of those institutions, intended to mitigate the changes in the intensity of risk and concerning:
- (i) the level of own funds laid down in Article 92;
  - (ii) the requirements for large exposures laid down in Article 392 and Article 395 to 403;
  - (iii) the public disclosure requirements laid down in Articles 431 to 455;
  - (iv) the level of the capital conservation buffer laid down in Article 129 of Directive 2013/36/EU;
  - (v) liquidity requirements laid down in Part Six;
  - (vi) risk weights for targeting asset bubbles in the residential and commercial property sector; or
  - (vii) intra financial sector exposures;
- (e) an explanation as to why the draft measures are deemed by the authority determined in accordance with paragraph 1 to be suitable, effective and proportionate to address the situation; and
- (f) an assessment of the likely positive or negative impact of the draft measures on the internal market based on information which is available to the Member State concerned.

3. When authorised to apply national measures in accordance with this Article, the authorities determined in accordance with paragraph 1 shall provide relevant competent authorities or designated authorities in other Member States with all relevant information.

4. The power to adopt an implementing act to reject the draft national measures referred to in point (d) of paragraph 2 is conferred on the Council, acting by qualified majority, on a proposal from the Commission.

Within one month of receiving the notification referred to in paragraph 2, the ESRB and EBA shall provide their opinions on the points mentioned in that paragraph to the Council, the Commission and the Member State concerned.

Taking utmost account of the opinions referred to in the second subparagraph and if there is robust, strong and detailed evidence that the measure will have a negative impact on the

internal market that outweighs the financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified, the Commission may, within one month, propose to the Council an implementing act to reject the draft national measures.

In the absence of a Commission proposal within that period of one month, the Member State concerned may immediately adopt the draft national measures for a period of up to two years or until the macroprudential or systemic risk ceases to exist if that occurs sooner.

The Council shall decide on the proposal by the Commission within one month after receipt of the proposal and state its reasons for rejecting or not rejecting the draft national measures.

The Council shall only reject the draft national measures if it considers that one or more of the following conditions are not complied with:

- (a) the changes in the intensity of macroprudential or systemic risk are of such nature as to pose risk to financial stability at national level;
- (b) Articles 124 and 164 of this Regulation and Articles 101, 103, 104, 105, 133, and 136 of Directive 2013/36/EU cannot adequately address the macroprudential or systemic risk identified, taking into account the relative effectiveness of those measures;
- (c) the draft national measures are more suitable to address the identified macroprudential or systemic risk and do not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the Union as a whole, thus forming or creating an obstacle to the functioning of the internal market;
- (d) the issue concerns only one Member State; and
- (e) the risks have not already been addressed by other measures in this Regulation or in Directive 2013/36/EU.

The assessment of the Council shall take into account the opinion of the ESRB and EBA and shall be based on the evidence presented in accordance with paragraph 2 by the authority determined in accordance with paragraph 1.

In the absence of a Council implementing act to reject the draft national measures within one month after receipt of the proposal by the Commission, the Member State may adopt the measures and apply them for a period of up to two years or until the macroprudential or systemic risk ceases to exist if that occurs sooner.



5. Other Member States may recognise the measures set in accordance with this Article and apply them to domestically authorised branches located in the Member State authorised to apply the measures.

6. Where Member States recognise the measures set in accordance with this Article, they shall notify the Council, the Commission, EBA, the ESRB and the Member State authorised to apply the measures.

7. When deciding whether to recognise the measures set in accordance with this Article, the Member State shall take into consideration the criteria set in paragraph 4.

8. The Member State authorised to apply the measures may ask the ESRB to issue a recommendation as referred to in Article 16 of Regulation (EU) No 1092/2010 to one or more Member States which do not recognise the measures.

9. Before the expiry of the authorisation issued in accordance with paragraph 4, the Member State shall, in consultation with the ESRB and EBA, review the situation and may adopt, in accordance with the procedure referred to in paragraph 4, a new decision for the extension of the period of application of national measures for one additional year each time. After the first extension, the Commission shall in consultation with the ESRB and EBA review the situation at least annually.

10. Notwithstanding the procedure as set out in paragraphs 3 to 9, Member States shall be allowed to increase the risk weights beyond those provided in this Regulation by up to 25 %, for those exposures identified in points (vi) and (vii) of paragraph 2(d) of this Article and tighten the large exposure limit provided in Article 395 by up to 15 % for a period of up to two years or until the macroprudential or systemic risk ceases to exist if that occurs sooner, provided that the conditions and notification requirements in paragraph 2 of this Article are met.

#### Article 459

##### Prudential requirements

The Commission shall be empowered to adopt delegated acts in accordance with Article 462, to impose, for a period of one year, stricter prudential requirements for exposures where this is necessary to address changes in the intensity of microprudential and macroprudential risks which arise from market developments in the Union or outside the Union affecting all Member States, and where the instruments of this Regulation and Directive 2013/36/EU 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 92;

(b) the requirements for large exposures laid down in Article 392 and Articles 395 to 403;

(c) the public disclosure requirements laid down in Articles 431 to 455.

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 this Article.

#### Article 460

##### Liquidity

1. The Commission shall be empowered to adopt a delegated act in accordance with Article 462 to specify in detail the general requirement set out in Article 412(1). The delegated act adopted in accordance with this paragraph shall be based on the items to be reported in accordance with Part Six, Title II and Annex III, shall specify under which circumstances competent authorities have to impose specific in- and outflow levels on credit institutions in order to capture specific risks to which they are exposed and shall respect the thresholds set out in paragraph 2.

2. The liquidity coverage requirement referred to in Article 412 shall be introduced in accordance with the following phasing-in:

(a) 60 % of the liquidity coverage requirement in 2015;

(b) 70 % as from 1 January 2016;

(c) 80 % as from 1 January 2017;

(d) 100 % as from 1 January 2018.

For this purpose the Commission shall take into account the reports referred to in Article 509(1), (2) and (3) and international standards developed by international fora as well as Union specificities.

The Commission shall adopt the delegated act referred to in paragraph 1 by 30 June 2014. It shall enter into force by 31 December 2014, but shall not apply before 1 January 2015.

#### Article 461

##### Review of the phasing-in of the liquidity coverage requirement

1. EBA shall, after consulting the ESRB, by 30 June 2016 report to the Commission on whether the phase-in of the liquidity coverage requirement as specified in Article 460(2) should be amended. Such analysis shall take due account of market and international regulatory developments as well as Union specificities.

EBA shall in its report assess in particular a deferred introduction of the 100 % minimum binding standard, until 1 January 2019. The report shall take into account the annual reports referred to in Article 509(1), relevant market data and the recommendations of all competent authorities.

2. Where necessary to address market and other developments, the Commission shall be empowered to adopt a delegated act in accordance with Article 462 to alter the phase-in specified in Article 460 and defer until 2019 the introduction of a 100 % binding minimum standard for the liquidity coverage requirement set out in Article 412(1) and to apply in 2018 a 90 % binding minimum standard for the liquidity coverage requirement.

For the purposes of assessing the necessity of deferral the Commission shall take into account the report and assessment referred to in paragraph 1.

A delegated act adopted in accordance with this Article shall not apply before 1 January 2018 and shall enter into force by 30 June 2017.

#### Article 462

##### 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 power to adopt delegated acts referred to in Articles 456 to 460 shall be conferred for an indeterminate period of time from 31 December 2014.

3. The delegation of power referred to in Articles 456 to 460 may be revoked at any time by the European Parliament or by the Council. A decision to revoke 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 456 to 460 shall enter into force only if no objection has been expressed by the European Parliament or the Council within a period of three 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 three months at the initiative of the European Parliament or of the Council.

#### Article 463

##### Objections to regulatory technical standards

Where the Commission adopts a regulatory technical standard pursuant to this Regulation which is the same as the draft regulatory technical standard submitted by EBA, the period during which the European Parliament and the Council may object to that regulatory technical standard shall be one month from the date of notification. At the initiative of the European Parliament or the Council that period shall be extended by one month. By way of derogation from the second subparagraph of Article 13(1) of Regulation (EU) No 1093/2010, the period during which the European Parliament or the Council may object to that regulatory technical standard may, where appropriate, be further extended by one month.

#### Article 464

##### European Banking Committee

1. The Commission shall be assisted by the European Banking Committee established by Commission Decision 2004/10/EC<sup>(1)</sup>. That committee shall be a committee within the meaning 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, REVIEWS AND AMENDMENTS

###### 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 465

##### Own funds requirements

1. By way of derogation from points (a) and (b) of Article 92(1) the following own funds requirements shall apply during the period from 1 January 2014 to 31 December 2014:

- (a) a Common Equity Tier 1 capital ratio of a level that falls within a range of 4 % to 4,5 %;
- (b) a Tier 1 capital ratio of a level that falls within a range of 5,5 % to 6 %.

<sup>(1)</sup> OJ L 3, 7.1.2004, p. 36.

2. Competent authorities shall determine and publish the levels of the Common Equity Tier 1 and Tier 1 capital ratios in the ranges specified in paragraph 1 that institutions shall meet or exceed.

#### Article 466

### First time application of International Financial Reporting Standards

By way of derogation from Article 24(2), competent authorities shall grant institutions which are required to effect the valuation of assets and off-balance sheet items and the determination of own funds in accordance with International Accounting Standards as applicable under Regulation (EC) No 1606/2002 for the first time a lead time of 24 months for the implementation of the necessary internal processes and technical requirements.

#### Section 2

### Unrealised gains and losses measured at fair value

#### Article 467

#### Unrealised losses measured at fair value

1. By way of derogation from Article 35, during the period from 1 January 2014 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 33 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) 20 % to 100 % during the period from 1 January 2014 to 31 December 2014;
- (b) 40 % to 100 % during the period from 1 January 2015 to 31 December 2015;
- (c) 60 % to 100 % during the period from 1 January 2016 to 31 December 2016; and
- (d) 80 % to 100 % for the period from 1 January 2017 to 31 December 2017.

By way of derogation from paragraph 1, the competent authorities may, in cases where such treatment was applied before 1 January 2014, allow institutions not to include in any element of own funds unrealised gains or losses on exposures to central governments classified in the "Available for Sale" category of EU-endorsed IAS 39.

The treatment set out in the second subparagraph shall be applied until the Commission has adopted a regulation on the basis of Regulation (EC) No 1606/2002 endorsing the International Financial Reporting Standard replacing IAS 39.

3. Competent authorities shall determine and publish the applicable percentage in the ranges specified in points (a) to (d) of paragraph 2;

#### Article 468

### Unrealised gains measured at fair value

1. By way of derogation from Article 35, during the period from 1 January 2014 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 33 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.

2. For the purposes of paragraph 1, the applicable percentage shall be 100 % during the period from 1 January 2014 to 31 December 2014, and shall, after that date, fall within the following ranges:

- (a) 60 % to 100 % during the period from 1 January 2015 to 31 December 2015;
- (b) 40 % to 100 % during the period from 1 January 2016 to 31 December 2016;
- (c) 20 % to 100 % for the period from 1 January 2017 to 31 December 2017.

From 1 January 2015, where under Article 467 a competent authority requires institutions to include in the calculation of Common Equity Tier 1 capital 100 % of their unrealised losses measured at fair value, that competent authority may also permit institutions to include in that calculation 100 % of their unrealised gains at fair value.

From 1 January 2015, where under Article 467 a competent authority requires institutions to include a percentage of unrealised losses measured at fair value in the calculation of Common Equity Tier 1 capital that competent authority may not set an applicable percentage of unrealised gains under paragraph 2 of this Article that exceeds the applicable percentage of unrealised losses set in accordance with Article 467.

3. Competent authorities shall determine and publish the applicable percentage of unrealised gains in the ranges specified in points (a) to (c) of paragraph 2 that is not removed from Common Equity Tier 1 capital.

4. By way of derogation from Article 33(1)(c), during the period from 1 January 2013 to 31 December 2017, institutions shall include in their own funds the applicable percentage, as specified in Article 478, of the fair value gains and losses from derivative liabilities arising from their own credit risk.

### Section 3

#### Deductions

##### Sub-Section 1

#### Deductions from Common Equity Tier 1 items

##### Article 469

#### Deductions from Common Equity Tier 1 items

1. By way of derogation from Article 36(1), during the period from 1 January 2014 to 31 December 2017, the following shall apply:

- (a) institutions shall deduct from Common Equity Tier 1 items the applicable percentage specified in Article 478 of the amounts required to be deducted pursuant to points (a) to (h) of Article 36(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 472 to the residual amounts of items required to be deducted pursuant to points (a) to (h) of Article 36(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 478 of the total amount required to be deducted pursuant to points (c) and (i) of Article 36(1) after applying Article 470;
- (d) institutions shall apply the requirements laid down in Article 472(5) or (11), as applicable, to the total residual amount of items required to be deducted pursuant to points (c) and (i) of Article 36(1) after applying Article 470.

2. Institutions shall determine the portion of the total residual amount referred to in point (d) of paragraph 1, that is subject to Article 472(5), by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:

(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 470(2);

(b) the sum of the amounts referred to in points (a) and (b) of Article 470(2).

3. Institutions shall determine the portion of the total residual amount referred to point (d) of paragraph 1 that is subject to Article 472(11) by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:

(a) the amount of direct and indirect holdings of the Common Equity Tier 1 instruments referred to in point (b) of Article 470(2);

(b) the sum of the amounts referred to in points (a) and (b) of Article 470(2).

##### Article 470

#### 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 32 to 35 and making the deductions pursuant to points (a) to (h), (k)(ii) to (v) and (l) of Article 36(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences.

2. By way of derogation from Article 48(1), during the period from 1 January 2014 to 31 December 2017, institutions shall not deduct the items listed in points (a) and (b) of this paragraph 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, indirect and synthetic 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 48(4), the items exempt from deduction pursuant to paragraph 2 of this Article shall be risk weighted at 250 %. The items referred to in point (b) of paragraph 2 of this Article shall be subject to the requirements of Title IV of Part Three, as applicable.

*Article 471***Exemption from Deduction of Equity Holdings in Insurance Companies from Common Equity Tier 1 Items**

1. By way of derogation from Article 49(1), during the period from 1 January 2014 to 31 December 2022, competent authorities may permit institutions to not deduct equity holdings in insurance undertakings, reinsurance undertakings and insurance holding companies where the following conditions are met:

- (a) the conditions laid down in points (a), (c) and (e) of Article 49(1);
- (b) the competent authorities are satisfied with the level of risk control and financial analysis procedures specifically adopted by the institution in order to supervise the investment in the undertaking or holding company;
- (c) the equity holdings of the institution in the insurance undertaking, reinsurance undertaking or insurance holding company do not exceed 15 % of the Common Equity Tier 1 instruments issued by that insurance entity as at 31 December 2012 and during the period from 1 January 2013 to 31 December 2022;
- (d) the amount of the equity holding which is not deducted does not exceed the amount held in the Common Equity Tier 1 instruments in the insurance undertaking, reinsurance undertaking or insurance holding company as at 31 December 2012.

2. The equity holdings which are not deducted pursuant to paragraph 1 shall qualify as exposures and be risk weighted at 370 %.

*Article 472***Items not deducted from Common Equity Tier 1**

1. By way of derogation from point (c) of Article 33(1) and points (a) to (i) of Article 36(1), during the period from 1 January 2014 to 31 December 2017, institutions shall apply this Article to the residual amounts of items referred to in Article 468(4) and in points (b) and (d) of Article 469(1), as applicable.

2. The residual amount of the valuation adjustments to derivative liabilities arising from an institution's own credit risk shall not be deducted.

3. Institutions shall apply the following to the residual amount of losses of the current financial year referred to in point (a) of Article 36(1):

(a) losses that are material are deducted from Tier 1 items;

(b) losses that are not material are not deducted.

4. Institutions shall deduct the residual amount of the intangible assets referred to in point (b) of Article 36(1) from Tier 1 items.

5. The residual amount of the deferred tax assets referred to in point (c) of Article 36(1) shall not be deducted and shall be subject to a risk weight of 0 %.

6. The residual amount of the items referred to in point (d) of Article 36(1) shall be deducted half from Tier 1 items and half from Tier 2 items.

7. The residual amount of the assets of a defined benefit pension fund referred to in point (e) of Article 36(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 in accordance with the national transposition measures for points (a) to (ca) of Article 57 of Directive 2006/48/EC.

8. 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 36(1):

(a) the amount of direct holdings is deducted from Tier 1 items;

(b) the amount of indirect and synthetic 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.

9. 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 36(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 36(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 36(1).



10. Institutions shall apply the following to the residual amounts of items referred to in point (h) of Article 36(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 and synthetic holdings are not deducted and are subject to a 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.

11. Institutions shall apply the following to the residual amounts of the items referred to in point (i) of Article 36(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 and synthetic 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.

#### Article 473

##### Introduction of amendments to IAS 19

1. By way of derogation from Article 481 during the period from 1 January 2014 until 31 December 2018, competent authorities may permit institutions that prepare their accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2) of Regulation (EC) No 1606/2002 to add to their Common Equity Tier 1 capital the applicable amount in accordance with paragraph 2 or 3 of this Article, as applicable, multiplied by the factor applied in accordance with paragraph 4.

2. The applicable amount shall be calculated by deducting from the sum derived in accordance with point (a) the sum derived in accordance with point (b):

- (a) institutions shall determine the values of the assets of their defined benefit pension funds or plans, as applicable, in accordance with Regulation (EC) No 1126/2008 <sup>(1)</sup> as amended by Regulation (EU) No 1205/2011 <sup>(2)</sup>. Institutions shall then deduct from the values of these assets the values of the obligations under the same funds or plans determined according to the same accounting rules;

<sup>(1)</sup> Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council (OJ L 320, 29.11.2008, p. 1).

<sup>(2)</sup> Commission Regulation (EU) No 1205/2011 of 22 November 2011 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard (IFRS) 7 (OJ L 305, 23.11.2011, p. 16).

- (b) institutions shall determine the values of the assets of their defined pension funds or plans, as applicable, according to the rules set out in Regulation (EC) No 1126/2008. Institutions shall then deduct from the values of those assets, the values of the obligations under the same funds or plans determined according to the same accounting rules.

3. The amount determined in accordance with paragraph 2 shall be limited to the amount not required to be deducted from own funds, prior to 1 January 2014, under national transposition measures of Directive 2006/48/EC, insofar as those national transposition measures would be eligible for the treatment set out in Article 481 of this Regulation in the Member State concerned.

4. The following factors apply:

- (a) 1 in the period from 1 January 2014 to 31 December 2014;
- (b) 0,8 in the period from 1 January 2015 to 31 December 2015;
- (c) 0,6 in the period from 1 January 2016 to 31 December 2016;
- (d) 0,4 in the period from 1 January 2017 to 31 December 2017;
- (e) 0,2 in the period from 1 January 2018 to 31 December 2018.

5. Institutions shall disclose the values of assets and liabilities in accordance with paragraph 2 in their published financial statements.

#### Sub-Section 2

##### Deductions from Additional Tier 1 items

#### Article 474

##### Deductions from Additional Tier 1 items

By way of derogation from Article 56, during the period from 1 January 2014 to 31 December 2017, the following shall apply:

- (a) institutions shall deduct from Additional Tier 1 items the applicable percentage specified in Article 478 of the amounts required to be deducted pursuant to Article 56;

- (b) institutions shall apply the requirements laid down in Article 475 to the residual amounts of the items required to be deducted pursuant to Article 56.

*Article 475*

**Items not deducted from Additional Tier 1 items**

1. By way of derogation from Article 56, during the period from 1 January 2014 to 31 December 2017, the requirements laid down in this Article shall apply to the residual amounts referred to in point (b) of Article 474.

2. Institutions shall apply the following to the residual amount of the items referred to in point (a) of Article 56:

(a) direct holdings of own Additional Tier 1 instruments are deducted at book value from Tier 1 items;

(b) indirect and synthetic 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 56:

(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, indirect and synthetic holdings of those Additional Tier 1 instruments of that entity is treated as falling within point (c) of Article 56;

(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, indirect and synthetic holdings of those Additional Tier 1 instruments of that entity is treated as falling within point (d) of Article 56.

4. Institutions shall apply the following to the residual amount of the items referred to in points (c) and (d) of Article 56:

(a) the amount relating to direct holdings required to be deducted in accordance with points (c) and (d) of Article 56 are deducted half from Tier 1 items and half from Tier 2 items;

(b) the amount relating to indirect and synthetic holdings required to be deducted in accordance with points (c) and (d) of Article 56 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 476*

**Deductions from Tier 2 items**

By way of derogation from Article 66, during the period from 1 January 2014 to 31 December 2017, the following shall apply:

(a) institutions shall deduct from Tier 2 items the applicable percentage specified in Article 478 of the amounts required to be deducted pursuant to Article 66;

(b) institutions shall apply the requirements laid down in Article 477 to the residual amounts required to be deducted pursuant to Article 66.

*Article 477*

**Deductions from Tier 2 items**

1. By way of derogation from Article 66, during the period from 1 January 2014 to 31 December 2017, the requirements laid down in this Article shall apply to the residual amounts referred to in point (b) of Article 476.

2. Institutions shall apply the following to the residual amount of items referred to in point (a) of Article 66:

(a) direct holdings of own Tier 2 instruments are deducted at book value from Tier 2 items;

(b) indirect and synthetic 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 66:

(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, indirect and synthetic holdings of the Tier 2 instruments of that entity is treated as falling within point (c) of Article 66;

(b) where the institution has a significant investment in a financial sector entity with which it has reciprocal cross holdings, the amount of direct, indirect and synthetic holdings of the Tier 2 instruments of that financial sector entity are treated as falling within point (d) of Article 66.

4. Institutions shall apply the following to the residual amount of the items referred to in points (c) and (d) of Article 66:

- (a) the amount relating to direct holdings that is required to be deducted in accordance with points (c) and (d) of Article 66 is deducted half from Tier 1 items and half from Tier 2 items;
- (b) the amount relating to indirect and synthetic holdings that is required to be deducted in accordance with points (c) and (d) of Article 66 is not be deducted and is 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 478

#### Applicable percentages for deduction from Common Equity Tier 1, Additional Tier 1 and Tier 2 items

1. The applicable percentage for the purposes of Article 468(4), points (a) and (c) of Article 469(1), point (a) of Article 474 and point (a) of Article 476 shall fall within the following ranges:

- (a) 20 % to 100 % for the period from 1 January 2014 to 31 December 2014;
- (b) 40 % to 100 % for the period from 1 January 2015 to 31 December 2015;
- (c) 60 % to 100 % for the period from 1 January 2016 to 31 December 2016;
- (d) 80 % to 100 % for the period from 1 January 2017 to 31 December 2017.

2. By way of derogation from paragraph 1, for the items referred in point (c) of Article 36(1) that existed prior to ..., the applicable percentage for the purpose of point (c) of Article 469(1) shall fall within the following ranges:

- (a) 0 % to 100 % for the period from 1 January 2014 to 2 January 2015;
- (b) 10 % to 100 % for the period from 2 January 2015 to 2 January 2016;
- (c) 20 % to 100 % for the period from 2 January 2016 to 2 January 2017;
- (d) 30 % to 100 % for the period from 2 January 2017 to 2 January 2018;
- (e) 40 % to 100 % for the period from 2 January 2018 to 2 January 2019;

- (f) 50 % to 100 % for the period from 2 January 2019 to 2 January 2020;
- (g) 60 % to 100 % for the period from 2 January 2020 to 2 January 2021;
- (h) 70 % to 100 % for the period from 2 January 2021 to 2 January 2022;
- (i) 80 % to 100 % for the period from 2 January 2022 to 2 January 2023;
- (j) 90 % to 100 % for the period from 2 January 2023 to 2 January 2024.

3. Competent authorities shall determine and publish an applicable percentage in the ranges specified in paragraphs 1 and 2 for each of the following deductions:

- (a) the individual deductions required pursuant to points (a) to (h) of Article 36(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;
- (b) 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 36(1) that is required to be deducted pursuant to Article 48;
- (c) each deduction required pursuant to points (b) to (d) of Article 56;
- (d) each deduction required pursuant to points (b) to (d) of Article 66.

#### Section 4

### Minority interest and Additional Tier 1 and Tier 2 instruments issued by subsidiaries

#### Article 479

#### 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 II of Part Two, during the period from 1 January 2014 to 31 December 2017, recognition in consolidated own funds of the items that would qualify as consolidated reserves in accordance with national transposition measures for 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 of this Article:

- (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) the items do not qualify as a result of Article 81(2);
- (c) the items do not qualify 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 2013/36/EU;
- (d) the items do not qualify 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 80 % for the period from 1 January 2014 to 31 December 2014;
- (b) 0 % to 60 % for the period from 1 January 2015 to 31 December 2015;
- (c) 0 % to 40 % for the period from 1 January 2016 to 31 December 2016;
- (d) 0 % to 20 % for the period from 1 January 2017 to 31 December 2017.

4. Competent authorities shall determine and publish the applicable percentage in the ranges specified in paragraph 3.

#### Article 480

#### **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 84(1), point (b) of Article 85(1) and point (b) of Article 87(1), during the period from 1 January 2014 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) 0,2 to 1 in the period from 1 January 2014 to 31 December 2014;
- (b) 0,4 to 1 in the period from 1 January 2015 to 31 December 2015;
- (c) 0,6 to 1 in the period from 1 January 2016 to 31 December 2016; and
- (d) 0,8 to 1 in the period from 1 January 2017 to 31 December 2017.

3. Competent authorities shall determine and publish the value of the applicable factor in the ranges specified in paragraph 2.

#### Section 5

#### **Additional filters and deductions**

##### Article 481

#### **Additional filters and deductions**

1. By way of derogation from Articles 32 to 36, 56 and 66, during the period from 1 January 2014 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 of this Regulation.

2. By way of derogation from Article 36(1)(i) and Article 49(1) and (3), during the period from the 1 January 2014 to 31 December 2014, competent authorities may require or permit institutions to apply the methods referred to in Article 49(1) where the requirements laid down in points (b) and (e) of Article 49(1) are not met, rather than the deduction required pursuant to Article 36(1). In such cases, the proportion of holdings of the own funds instruments of a financial sector entity in which the parent undertaking has a significant investment that is not required to be deducted in accordance with Article 49(1) shall be determined by the applicable percentage referred to in paragraph 4 of this Article. The amount that is not deducted shall be subject to the requirements of Article 49(4), as applicable.

3. For the purposes of paragraph 1, the applicable percentage shall fall within the following ranges:

- (a) 0 % to 80 % for the period from 1 January 2014 to 31 December 2014;
- (b) 0 % to 60 % for the period from 1 January 2015 to 31 December 2015;
- (c) 0 % to 40 % for the period from 1 January 2016 to 31 December 2016;
- (d) 0 % to 20 % for the period from 1 January 2017 to 31 December 2017.

4. For the purpose of paragraph 2, the applicable percentage shall fall between 0 % and 50 % for the period from 1 January 2014 to 31 December 2014.

5. For each filter or deduction referred to in paragraphs 1 and 2, competent authorities shall determine and publish the applicable percentages in the ranges specified in paragraphs 3 and 4.

6. 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 of this Regulation are, for the purposes of this Article, to 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 February 2014.

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

#### Article 482

### Scope of application for derivatives transactions with pension funds

In respect of those transactions referred to in Article 89 of Regulation (EU) No 648/2012 and entered into with a pension scheme arrangement as defined in Article 2 of that Regulation, institutions shall not calculate own funds requirements for CVA risk as provided for in Article 382(4)(c) of this Regulation.

#### CHAPTER 2

### Grandfathering of capital instruments

#### Section 1

### Instruments constituting State aid

#### Article 483

### Grandfathering of State aid instruments

1. By way of derogation from Articles 26 to 29, 51, 52, 62 and 63 during the period from 1 January 2014 to 31 December 2017, this Article applies to capital instruments and items where the following conditions are met:

- (a) the instruments were issued prior to 1 January 2014;
- (b) the instruments were issued within the context of recapitalisation measures pursuant to State aid rules. Insofar as part of the instruments are privately subscribed, they must

be issued prior to 30 June 2012 and in conjunction with those parts that are subscribed by the Member State;

- (c) the instruments were considered compatible with the internal market by the Commission under Article 107 TFEU;
- (d) in cases where the instruments are subscribed by both the Member State and private investors, where there is a partial redemption of the instruments subscribed by the Member State, a corresponding share of the privately subscribed part of the instruments shall be grandfathered in accordance with Article 484. When all the instruments subscribed by the Member State have been redeemed, the remaining instruments subscribed by private investors shall be grandfathered in accordance with Article 484.

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 28 of this Regulation are not met;
- (b) the instruments were issued by an undertaking referred to in Article 27 of this Regulation and the conditions laid down in Article 28 of this Regulation or, where applicable, Article 29 of this Regulation are not met.

3. Instruments referred to in point (c) of paragraph 1 of this Article that do not qualify under national transposition measures for point (a) of Article 57 of Directive 2006/48/EC shall qualify as Common Equity Tier 1 instruments notwithstanding the requirements of point (a) or (b) of paragraph 2 of this Article not being met, provided that the requirements of paragraph 8 of this Article are met.

Instruments that qualify as Common Equity Tier 1 pursuant to the first subparagraph may not qualify as Additional Tier 1 instruments or Tier 2 instruments under paragraph 5 or 7.

4. Instruments that qualified in accordance with the national transposition measures for point (ca) of Article 57 and for Article 66(1) of Directive 2006/48/EC shall qualify as Additional Tier 1 instruments notwithstanding the conditions laid down in Article 52(1) of this Regulation not being met.

5. Instruments referred to in point (c) of paragraph 1 of this Article that do not qualify under the national transposition measures for point (ca) of Article 57 of Directive 2006/48/EC shall qualify as Additional Tier 1 instruments notwithstanding the conditions laid down in Article 52(1) of this Regulation not being met, provided that the requirements of paragraph 8 of this Article are met.



Instruments that qualify as Additional Tier 1 instruments pursuant to the first subparagraph may not qualify as Common Equity Tier 1 instruments or Tier 2 instruments under paragraph 3 or 7.

6. 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 62 of this Regulation or the conditions laid down in Article 63 of this Regulation not being met.

7. Instruments referred to in point (c) of paragraph 1 of this Article that do not qualify under the national transposition measures for point (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 62 of this Regulation or the conditions laid down in Article 63 of this Regulation not being met, provided the conditions in paragraph 8 of this Article are met.

Instruments that qualify as Tier 2 instruments pursuant to the first subparagraph may not qualify as Common Equity Tier 1 instruments or Additional Tier 1 instruments under paragraph 3 or 5.

8. Instruments referred to paragraphs 3, 5 and 7 may qualify as own funds instruments referred to in those paragraphs only where the condition in point (a) of paragraph 1 is met and where they are issued by institutions that are incorporated in a Member State that is subject to an Economic Adjustment Programme, and the issuance of those instruments is agreed or eligible under that programme.

## Section 2

### Instruments not constituting state aid

#### Sub-Section 1

### Grandfathering eligibility and limits

#### Article 484

#### **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 and items that were issued or were eligible as own funds prior to 31 December 2011 and are not those referred to in Article 483(1).

2. By way of derogation from Articles 26 to 29, 51, 52, 62 and 63, this Article shall apply during the period from 1 January 2014 to 31 December 2021.

3. Subject to Article 485 of this Regulation and to the limit specified in Article 486(2) thereof, capital within the meaning of Article 22 of Directive 86/635/EEC, 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 Article 28 or, where applicable, Article 29 of this Regulation.

4. Subject to the limit specified Article 486(3) of this Regulation, 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/EC shall qualify as Additional Tier 1 items, notwithstanding the conditions laid down in Article 52 of this Regulation not being met.

5. Subject to the limits specified in Article 486(4) of this Regulation, 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 62 of this Regulation or the conditions laid down in Article 63 of this Regulation not being met.

#### Article 485

#### **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 483(1).

2. Share premium accounts related to capital within the meaning of Article 22 of Directive 86/635/EEC, 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 they meet the conditions laid down in points (i) and (j) of Article 28 of this Regulation.

#### Article 486

#### **Limits for grandfathering of items within Common Equity Tier 1, Additional Tier 1 and Tier 2 items**

1. During the period from 1 January 2014 to 31 December 2021, the extent to which instruments and items referred to in Article 484 shall qualify as own funds shall be limited in accordance with this Article.

2. The amount of items referred to in Article 484(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) of this paragraph:

(a) the nominal amount of capital referred to in Article 484(3) that were in issue on 31 December 2012;

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

3. The amount of items referred to in Article 484(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) of this paragraph the sum of the amounts specified in points (c) to (f) of this paragraph:

- (a) the nominal amount of instruments referred to in Article 484(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 484(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 Article 484(4) that were in issue on 31 December 2012 but do not qualify as Additional Tier 1 instruments pursuant to Article 489(4);
- (f) the share premium accounts related to the instruments referred to in point (e).

4. The amount of items referred to in Article 484(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) of this paragraph the sum of amounts specified in points (e) to (h) of this paragraph:

- (a) the nominal amount of instruments referred to in Article 484(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 484(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 484(5) that were in issue on 31 December 2012 that exceeded the limits specified in the national trans-

position 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 484(5) that were in issue on 31 December 2012 that do not qualify as Tier 2 items pursuant to Article 490(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) 60 % to 80 % during the period from 1 January 2014 to 31 December 2014;
- (b) 40 % to 70 % during the period from 1 January 2015 to 31 December 2015;
- (c) 20 % to 60 % during the period from 1 January 2016 to 31 December 2016;
- (d) 0 % to 50 % during the period from 1 January 2017 to 31 December 2017;
- (e) 0 % to 40 % during the period from 1 January 2018 to 31 December 2018;
- (f) 0 % to 30 % during the period from 1 January 2019 to 31 December 2019;
- (g) 0 % to 20 % during the period from 1 January 2020 to 31 December 2020;
- (h) 0 % to 10 % during the period from 1 January 2021 to 31 December 2021.

6. Competent authorities shall determine and publish the applicable percentages in the ranges specified in paragraph 5.

#### Article 487

#### **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 51, 52, 62 and 63, during the period from 1 January 2014 to 31 December 2021, institutions may treat as items referred to in Article 484(4), capital, and the related share premium accounts, referred to in Article 484(3) that are excluded from Common Equity Tier 1 items because they exceed the applicable percentage specified in Article 486(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 486(3).

2. By way of derogation from Articles 51, 52, 62 and 63, during the period from 1 January 2014 to 31 December 2021, institutions may treat the following as items referred to in Article 484(5), to the extent that their inclusion does not exceed the applicable percentage limit referred to in Article 486(4):

(a) capital, and the related share premium accounts, referred to in Article 484(3) that are excluded from Common Equity Tier 1 items because they exceed the applicable percentage specified in Article 486(2);

(b) instruments, and the related share premium accounts, referred to in Article 484(4) that exceed the applicable percentage referred to in Article 486(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 486(4) or (5) during the period from 1 January 2014 to 31 December 2021.

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

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

#### Article 488

##### **Amortisation of items grandfathered as Tier 2 items**

The items referred to in Article 484(5) that qualify as Tier 2 items referred to in Article 484(5) or Article 486(4) shall be subject to the requirements laid down in Article 64.

#### Sub-Section 2

##### **Inclusion of instruments with a call and incentive to redeem in Additional Tier 1 and Tier 2 items**

#### Article 489

##### **Hybrid instruments with a call and incentive to redeem**

1. By way of derogation from Articles 51 and 52, during the period from 1 January 2014 to 31 December 2021, instruments referred to in Article 484(4) that 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 of this Article.

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 52 are met from 1 January 2013.

3. The instruments shall qualify as Additional Tier 1 instruments with their recognition reduced in accordance with Article 484(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 52 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 484(4), from 1 January 2014 where the following conditions are met:

(a) the institution was able to exercise a call with an incentive to redeem between 31 December 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 52 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 484(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 52 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 484(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 31 December 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 52 were not met from the date of the effective maturity of the instruments.

#### Article 490

##### Tier 2 items with an incentive to redeem

1. By way of derogation from Articles 62 and 63, during the period from 1 January 2014 to 31 December 2021, items referred to in Article 484(5) that qualified under the national transposition measures for point (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 of this Article.

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 63 are met.

3. The items shall qualify as Tier 2 items in accordance with Article 484(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 63 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 31 December 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 63 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 484(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 63 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 484(5) where:

- (a) the institution was able to exercise a call with an incentive to redeem only prior to or on 31 December 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 63 are not met from the date of the effective maturity of the items.

#### Article 491

##### Effective maturity

For the purposes of Articles 489 and 490, 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 31 December 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 31 December 2011.

## CHAPTER 3

**Transitional provisions for disclosure of own funds**

## Article 492

**Disclosure of own funds**

1. Institutions shall apply this Article during the period from 1 January 2014 to 31 December 2021.

2. During the period from 1 January 2014 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 465.

3. During the period from 1 January 2014 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 467 to 470, 474, 476 and 479;
- (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 481;
- (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 2014 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 484.

5. EBA shall develop draft implementing technical standards to specify uniform templates for disclosure made in accordance with this Article. The templates shall include the items listed in points (a), (b), (d) and (e) of Article 437(1), as amended by Chapters 1 and 2 of this Title.

EBA shall submit those draft implementing technical standards to the Commission by 1 February 2014.

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

## CHAPTER 4

**Large exposures, own funds requirements, leverage and the Basel I floor**

## Article 493

**Transitional provisions for large exposures**

1. The provisions on large exposures as laid down in Articles 387 to 403 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 Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field<sup>(1)</sup> did not apply on 31 December 2006. This exemption is available until 31 December 2017 or the date of entry into force of any amendments pursuant to paragraph 2 of this Article, whichever is the earlier.

2. By 31 December 2015, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the European 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 400(2) and (3), Member States may, for a transitional period until the entry into force of any legal act following the review in accordance with Article 507, but not after 2 January 2029, fully or partially exempt the following exposures from the application of Article 395(1):

- (a) covered bonds falling within Article 129(1), (3) and (6);
- (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;

<sup>(1)</sup> OJ L 141, 11.6.1993, p. 27.



- (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 those criteria, whether or not exempted from Article 395(1) of this Regulation, 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 belongs to 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 and are not denominated in a major trading currency;
- (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 exposure amounts;
- (k) assets items constituting claims on and other exposures to recognised exchanges.

#### Article 494

##### Transitional provisions for eligible capital

By way of derogation from point (71)(b) of Article 4(1), eligible capital may include Tier 2 capital up to the following amounts:

- (a) 100 % of Tier 1 capital during the period from 1 January 2014 to 31 December 2014;
- (b) 75 % of Tier 1 capital during the period from 1 January 2015 to 31 December 2015;
- (c) 50 % of Tier 1 capital during the period from 1 January 2016 to 31 December 2016.

#### Article 495

##### Treatment of equity exposures under the IRB Approach

1. By way of derogation from Chapter 3 of Part Three, until 31 December 2017, the competent authorities 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 that treatment in accordance with Article 143 of Directive 2013/36/EU.

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 part of the holding which constitutes the excess 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 Three, Title II, Chapter 2 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 114(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. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall afford the exemption referred to in paragraph 1.

EBA shall submit those draft regulatory technical standards to the Commission by 30 June 2014.

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

#### Article 496

##### Own funds requirements for covered bonds

1. Until 31 December 2017 competent authorities may waive in full or in part the 10 % limit for senior units issued by French Fonds Communs de Créances or by securitisation entities which are equivalent to French Fonds Communs de Créances laid down in points (d) and (e) of Article 129(1), provided that both of the following conditions are fulfilled:

- (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 a member, or by an entity affiliated to the same central body to which the issuer of the covered bonds is 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 a member, or an entity affiliated to the same central body to which the issuer of the covered bonds is affiliated, retains the whole first loss tranche supporting those senior units.

2. Until 31 December 2014, for the purposes of point (c) of Article 129(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.

3. Until 31 December 2014, for the purposes of Article 129(5), 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 a 20 % risk weight.

#### Article 497

##### Own funds requirements for exposures to CCPs

1. Up until 15 months after the date of entry into force of the latest of the eleven regulatory technical standards referred to at the end of the first subparagraph of Article 89(3) of Regulation (EU) 648/2012, or until a decision is made under Article 14 of that Regulation on the authorisation of the CCP, whichever date is earlier, an institution may consider that CCP to be a  $Q_{CCP}$ , provided that the condition laid down in the first part of that subparagraph has been met.

2. Up until 15 months after the date of entry into force of the latest of the ten regulatory technical standards referred to at the end of the second subparagraph of Article 89(3) of Regulation (EU) 648/2012, or until a decision is made under Article 25 of that Regulation on the recognition of the CCP established in a third country, whichever date is earlier, an institution may consider that CCP to be a  $Q_{CCP}$ .

3. The Commission may adopt an implementing act under Article 5 of Regulation (EU) No 182/2011 extending the transitional provisions in paragraphs 1 and 2 of this Article by a further six months, in exceptional circumstances where it is necessary and proportionate to avoid disruption to international financial markets.

4. Up until the deadlines defined in paragraphs 1 and 2, and extended under paragraph 3, as applicable, where a CCP does not have a default fund and it does not have in place a binding arrangement with its clearing members that allows it to use all or part of the initial margin received from its clearing members as if they were pre-funded contributions, an institution shall substitute the right formula for calculating the own funds requirement ( $K_i$ ) in Article 308(2) with the following one:

$$K_i = \left( 1 + \beta \cdot \frac{N}{N-2} \right) \cdot \frac{IM_i}{IM} \cdot K_{CM}$$

where

$IM_i$  = the initial margin posted to the CCP by clearing member  $i$

$IM$  = the total amount of initial margin communicated to the institution by the CCP.

#### Article 498

##### Exemption for Commodities dealers

1. The provisions on own funds 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 2017 or the date of entry into force of any amendments pursuant to paragraphs 2 and 3, whichever is the earlier.

2. By 31 December 2015, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the European 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 499

##### Leverage

1. By way of derogation from Articles 429 and 430, during the period between 1 January 2014 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 1 and 2 of this Title.

2. By way of derogation from Article 451(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 of this Article. 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 429(2), during the period from 1 January 2014 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 500

##### Transitional provisions – Basel I floor

1. Until 31 December 2017, 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 92;

(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 as that Directive and Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions<sup>(1)</sup> stood prior to 1 January 2007.

2. Subject to the approval of the competent authorities, the amount referred to in point (b) of paragraph 1 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 that the institution would be required to hold under Article 92 calculating risk weighted exposure amounts in accordance with Part Three, Title II, Chapter 2, and Part Three, Title III, Chapter 2 or 3, as applicable, instead of in accordance with Part Three, Title II, Chapter 3, or Part Three, Title III, Chapter 4, as applicable.

3. A credit institution may apply paragraph 2 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.

4. Compliance with the requirements of point (b) of paragraph 1 shall be on the basis of amounts of own funds fully adjusted to reflect differences in the calculation of own funds under Directive 93/6/EEC and Directive 2000/12/EC 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.

<sup>(1)</sup> OJ L 126, 26.5.2000, p. 1.

5. The competent authorities may, after having consulted EBA, waive the application of point (b) of paragraph 1 to institutions provided that all the requirements for the Internal Ratings Based Approach set out in Part Three, Title II, Chapter 3, Section 6 or the qualifying criteria for the use of the Advanced Measurement Approach set out in Part Three, Title III, Chapter 4, as applicable, are met.

6. The Commission shall by 1 January 2017 submit a report to the European Parliament and the Council on whether it is appropriate to extend the application of the Basel I floor beyond 31 December 2017 to ensure that there is a backstop to internal models, taking into account international developments and internationally agreed standards. That report shall be accompanied by a legislative proposal if appropriate.

#### Article 501

#### **Capital requirements deduction for credit risk on exposures to SMEs**

1. Capital requirements for credit risk on exposures to SMEs shall be multiplied by the factor 0,7619.

2. For the purpose of this Article:

- (a) the exposure shall be included either in the retail or in the corporates or secured by mortgages on immovable property classes. Exposures in default shall be excluded;
- (b) an SME is defined in accordance with Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises<sup>(1)</sup>. Among the criteria listed in Article 2 of the Annex to that Recommendation only the annual turnover shall be taken into account;
- (c) the total amount owed to the institution and parent undertakings and its subsidiaries, including any exposure in default, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential property collateral, shall not, to the knowledge of the institution, exceed EUR 1,5 million. The institution shall take reasonable steps to acquire this knowledge.

3. Institutions shall report to competent authorities every three months on the total amount of exposures to SMEs calculated in accordance with paragraph 2.

4. The Commission shall by 2 January 2017, report on the impact of the own funds requirements laid down in this Regulation on lending to SMEs and natural persons and shall submit that report to the European Parliament and to the Council, together with a legislative proposal if appropriate.

5. For the purpose of paragraph 4, EBA shall report the following to the Commission:

- (a) analysis of the evolution of the lending trends and conditions for SMEs over the period referred to in paragraph 4;
- (b) analysis of effective riskiness of Union SMEs over a full economic cycle;
- (c) the consistency of own funds requirements laid down in this Regulation for credit risk on exposures to SMEs with the outcomes of the analysis under points (a) and (b).

#### TITLE II

#### REPORTS AND REVIEWS

#### Article 502

#### **Cyclicality of capital requirements**

The Commission, in cooperation with EBA, ESRB and the Member States, and taking into account the opinion of the ECB, shall periodically monitor whether this Regulation taken as a whole, together with Directive 2013/36/EU 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, 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 opinion of the ECB, 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.

By 31 December 2014 the Commission shall review and report on the application of Article 33(1)(c) and shall submit that report to the European Parliament and the Council, together with a legislative proposal if appropriate.

With respect to the potential elimination of the Article 33(1)(c) and its potential application at the Union level, the review shall in particular ensure that sufficient safeguards are in place to ensure financial stability in all Member States.

#### Article 503

#### **Own funds requirements for exposures in the form of covered bonds**

1. The Commission shall, by 31 December 2014, after consulting EBA, report to the European Parliament and to the Council, together with any appropriate proposals, on whether the risk weights laid down in Article 129 and the own funds requirements for specific risk in Article 336(3) are adequate for all the instruments that qualify for these treatments and whether the criteria in Article 129 are appropriate.

<sup>(1)</sup> OJ L 124, 20.5.2003, p. 36.



2. The report and the proposals referred to in paragraph 1 shall have regard to:

- (a) the extent to which the current regulatory capital requirements applicable to covered bonds adequately differentiate between variances in the credit quality of covered bonds and the collateral against which they 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, including the mitigating effects of the underlying strict national legal framework in accordance with Article 129 of this Regulation and Article 52(4) of Directive 2009/65/EC on the overall credit quality of a covered bond and its implications on the level of transparency needed by investors; and
- (c) the extent to which covered bond issuance by a credit institution impacts on the credit risk to which other creditors of the issuing institution are exposed.

3. The Commission shall, by 31 December 2014, after consulting EBA, report to the European Parliament and the Council on whether loans secured by aircrafts (aircraft liens) and whether residential loans secured by a guarantee, but not secured by a registered mortgage, should under certain conditions be considered as an eligible asset in accordance with Article 129.

4. The Commission shall, by 31 December 2016, review the appropriateness of the derogation set out in Article 496 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 462 to make that derogation permanent or make legislative proposals to extend it to other forms of covered bonds.

#### Article 504

#### **Capital instruments subscribed by public authorities in emergency situations**

The Commission shall, by 31 December 2016, after consulting EBA, report to the European Parliament and the Council, together with any appropriate proposals, whether the treatment set out in Article 31 needs to be amended or removed.

#### Article 505

#### **Review of long-term financing**

By 31 December 2014, the Commission shall report to the European Parliament and to the Council, together with any appropriate proposals, about the appropriateness of the requirements of this Regulation in light of the need to ensure adequate levels of funding for all forms of long-term financing for the economy, including critical infrastructure projects in the Union in the field of transport, energy and communications.

#### Article 506

#### **Credit risk – definition of default**

EBA shall, by 31 December 2017, report to the Commission on how replacing 90 days by 180 days past due, as provided in point (b) of Article 178(1), impacts risk-weighted exposure amounts and the appropriateness of the continued application of that provision after 31 December 2019.

On the basis of that report, the Commission may submit a legislative proposal to amend this Regulation.

#### Article 507

#### **Large exposures**

By 31 December 2015, the Commission shall review and report on the application of Article 400(1)(j) and Article 400(2), including whether the exemptions set out in Article 400(2) is to be discretionary, and shall submit that report to the European Parliament and to the Council, together with a legislative proposal if appropriate.

With respect to the potential elimination of the national discretion under Article 400(2)(c) and its potential application at the Union level, the review shall in particular take into account the efficiency of group risk management while ensuring that sufficient safeguards are in place to ensure financial stability in all Member States in which an entity belonging to a group is incorporated.

#### Article 508

#### **Level of application**

1. By 31 December 2014, the Commission shall review and report on the application of Part One, Title II, and Article 113(6) and (7) and shall submit that report to the European Parliament and the Council, together with a legislative proposal if appropriate.

2. By 31 December 2015, 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 that report to the European Parliament and to the Council, together with a legislative proposal if appropriate.



3. By 31 December 2015, the Commission shall, after consulting EBA and ESMA and in the light of discussions with the competent authorities, report to the European Parliament and to the Council on an appropriate regime for the prudential supervision of investment firms and of firms referred to in points (2)(b) and (c) of Article 4(1). Where appropriate the report shall be followed by a legislative proposal.

#### Article 509

##### Liquidity requirements

1. EBA shall monitor and evaluate the reports made in accordance with Article 415(1), across currencies and across different business models. EBA shall, after consulting the ESRB, non-financial end-users, the banking industry, competent authorities and the ESCB central banks annually and for the first time by 31 December 2013 report to the Commission on whether a specification of the general liquidity coverage requirement in Part Six based on the items to be reported in accordance with Part Six, Title II and Annex III, considered either individually or cumulatively, is likely to have a material detrimental impact on the business and risk profile of institutions established in the Union or on the stability and orderly functioning of financial markets or on the economy and the stability of the supply of bank lending, with a particular focus on lending to SMEs and on trade financing, including lending under official export credit insurance schemes.

The report referred to in the first subparagraph shall take due account of markets and international regulatory developments as well as of the interactions of the liquidity coverage requirement with other prudential requirements under this Regulation such as the risk based capital ratios as set out in Article 92 and the leverage ratio.

The European Parliament and the Council shall be given the opportunity to state their views on the report referred to in the first subparagraph.

2. EBA shall in the report referred to in paragraph 1 assess the following in particular:

- (a) the provision of mechanisms restricting the value of liquidity inflows, in particular with a view to determining an appropriate inflow cap and the conditions for its application, taking into account different business models including pass through financing, factoring, leasing, covered bonds, mortgages, issuance of covered bonds, and the extent to which that cap should be amended or removed to cater for the specificities of specialised financing;
- (b) the calibration of inflows and outflows referred to in Part Six, Title II, in particular under Article 422(7) and Article 425(2);
- (c) the provision of mechanisms restricting the coverage of liquidity requirements by certain categories of liquid assets, in particular assessing the appropriate minimum percentage for liquid assets referred to in points (a), (b) and (c) of Article 416(1) to the total of liquid assets, testing a threshold of 60 % and taking into account international regulatory developments. Assets owed and due or callable within 30 calendar days should not count towards the limit unless the assets have been obtained against collateral that also qualifies under points (a), (b) and (c) of Article 416(1);
- (d) the provision of specific lower outflow and/or higher inflow rates for intragroup flows, specifying under which conditions such specific in- or outflow rates would be justified from a prudential point of view and setting 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;
- (e) the calibration of the draw-down rates applicable to the undrawn committed credit and liquidity facilities that fall under Article 424(3) and (5). In particular, EBA shall test a draw-down rate of 100 %;
- (f) the definition of retail deposit in point (2) of Article 411, in particular the appropriateness of introducing a threshold on deposits of natural persons;
- (g) the need to introduce a new retail deposit category with a lower outflow in the light of the specific characteristics of such deposits that could justify a lower outflow rate and taking into account international developments;
- (h) 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 to which such derogations should be subject;
- (i) the definition of Shari'ah-compliant financial products as an alternative to assets that would qualify as liquid assets for the purposes of Article 416, for the use of Shari'ah-compliant banks;
- (j) the definition of circumstances of stress, including principles for the 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;
- (k) the definition of established operational relationship for non-financial customer as referred to in Article 422(3)(c);

- (l) the calibration of the outflow rate applicable to correspondent banking and prime brokerage services as referred to in the first subparagraph of Article 422(4);
- (m) mechanisms for the grandfathering of government guaranteed bonds issued to credit institutions as part of Government support measures with Union State aid approval, such as bonds issued by the National Asset Management Agency (NAMA) in Ireland and by the Spanish Asset Management Company in Spain, designed to remove problem assets from the balance sheets of credit institutions, as assets of extremely high liquidity and credit quality until at least December 2023.

3. EBA shall, after consulting ESMA and the ECB, by 31 December 2013, report to the Commission on appropriate uniform definitions of high and of extremely high liquidity and credit quality of transferable assets for the purposes of Article 416 and appropriate haircuts for assets that would qualify as liquid assets for the purposes of Article 416, with the exception of assets referred to in points (a), (b) and (c) of Article 416(1).

The European Parliament and the Council shall be given the opportunity to state their views on that report.

The report referred to in the first subparagraph shall also consider:

- (a) other categories of assets, in particular residential mortgage-backed securities of high liquidity and credit quality;
- (b) other categories of central bank eligible securities or loans, for example local government bonds and commercial paper; and
- (c) other non-central bank eligible but tradable assets, for example equities listed on a recognised exchange, gold, major index linked equity instruments, guaranteed bonds, covered bonds, corporate bonds and funds based on those assets.

4. The report referred to in paragraph 3 shall consider whether, and if, to what extent standby credit facilities referred to in point (e) of Article 416(1) should be included as liquid assets in light of international development and taking into account European specificities, including the way monetary policy is performed in the Union.

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.

5. By 31 January 2014, EBA shall furthermore report on the following:

- (a) uniform definitions of high and extremely high liquidity and credit quality;
- (b) the possible unintended consequences of the definition of liquid assets on the conduct of monetary policy operation and the extent to which:
  - (i) a list of liquid assets that is disconnected from the list of central bank eligible assets may incentivise institutions to submit eligible assets which are not included in the definition of liquid assets in refinancing operations;
  - (ii) regulation of liquidity may disincentivise institutions to lend or borrow on the unsecured money market and whether this may lead to question the targeting of EONIA in monetary policy implementation;
  - (iii) the introduction of the liquidity coverage requirement may make it more difficult for central banks to ensure price stability by using the existing monetary policy framework and instruments;
- (c) the operational requirements for the holdings of liquid assets, as referred in points (b) to (f) of Article. 417, in line with international regulatory developments.

#### Article 510

##### Net Stable Funding Requirements

1. By 31 December 2015, EBA shall report to the Commission, on the basis of the items to be reported in accordance with Part Six, Title III, 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 institutions established in the Union or on financial markets or the economy and bank lending, with a particular focus on lending to SMEs and on trade financing, including lending under official export credit insurance schemes and pass through financing models, including match funded mortgage lending. In particular EBA shall analyse the impact of stable sources of funding on the refinancing structures of different banking models in the Union.

2. By 31 December 2015, EBA shall also report to the Commission, on the basis of the items to be reported in accordance with Part Six, Title III and in accordance with the uniform reporting formats referred to in point (a) of Article 415(3) and after consulting the ESRB, on methodologies for determining the amount of stable funding available to and required by institutions and on appropriate uniform definitions for calculating such a net stable funding requirement, examining in particular the following:

- (a) the categories and weightings applied to sources of stable funding in Article 427(1);
- (b) the categories and weightings applied to determine the requirement for stable funding in Article 428(1);
- (c) methodologies shall provide incentives and disincentives as appropriate to encourage a more stable longer term funding of assets, business activities, investment and funding of institutions;
- (d) the need to develop different methodologies for different types of institutions.

3. By 31 December 2016, the Commission shall, if appropriate, and taking into account the reports referred to in paragraphs 1 and 2, and taking full account of the diversity of the banking sector in the Union, submit a legislative proposal to the European Parliament and the Council on how to ensure that institutions use stable sources of funding.

#### Article 511

##### Leverage

1. Based on the results of the report referred to in paragraph 3, 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.

2. Where appropriate, the report shall be accompanied by a legislative proposal on the introduction of an appropriate number of levels of the leverage ratio that institutions following different business models 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 referred to in Article 429, together with any connected flexibility measures if necessary, including appropriate amendments to Article 458 to introduce the leverage ratio within the scope of measures included in that Article.

3. For the purposes of paragraph 1, EBA shall report to the Commission by 31 October 2016 on at least the following:

- (a) whether the leverage ratio framework provided by this Regulation and Articles 87 and 98 of Directive 2013/36/EU is the appropriate tool to suppress the risk of excessive leverage on the part of the institutions in a satisfactory manner and degree;
- (b) on identifying business models that reflect the overall risk profiles of the institutions and on introducing differentiated levels of the leverage ratio for those business models;
- (c) whether the requirements laid out in Articles 76 and 87 of Directive 2013/36/EU in accordance with Articles 73 and 97 of Directive 2013/36/EU for addressing the risk of excessive leverage are sufficient to ensure sound management of this risk by institutions and, if not, which further enhancements are needed in order to ensure these objectives;
- (d) whether – and if so, which – changes to the calculation methodology referred to in Article 429 would be necessary to ensure that the leverage ratio can be used as an appropriate indicator of an institution's risk of excessive leverage;
- (e) whether, in the context of the calculation of the total exposure measure of the leverage ratio, the exposure value of contracts 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;
- (f) 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;
- (g) whether the conversion factor referred to in point (a) of Article 429(10) 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;
- (h) whether the frequency and format of the disclosure of items referred to in Article 451 are adequate;
- (i) what would be the appropriate level for the leverage ratio for each of the business models identified in accordance with point (b);
- (j) whether a range for each level of the leverage ratio should be defined;

- (k) 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;
- (l) 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 be determined according to the risk profile and business model as well as the size of institutions and, with regard to this, which additional calibrations or transition period would be required.

4. The report referred to in paragraph 3 shall cover at least the period from 1 January 2014 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 429, 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; in particular as regards low-risk areas of business, such as promotional credit by public development banks, municipal loans, financing of residential property and other low-risk areas regulated under national law;
  - (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 and the operation of a central counterparty;
  - (viii) cyclical nature of the capital measure and the total exposure measure of the leverage ratio;
  - (ix) bank lending, with a particular focus on lending to SMEs, local authorities, regional governments and public sector entities 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/EEC and other applicable accounting framework and other relevant accounting frameworks on the comparability of the leverage ratio.

#### Article 512

##### Exposures to transferred credit risk

By 31 December 2014 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 513

##### Macroprudential rules

1. By 30 June 2014, the Commission shall, after consulting the ESRB and EBA, review whether the macroprudential rules contained in this Regulation and Directive 2013/36/EU are sufficient to mitigate systemic risks in sectors, regions and Member States including assessing:

- (a) whether the current macroprudential tools in this Regulation and Directive 2013/36/EU are effective, efficient and transparent;
- (b) whether the coverage and the possible degrees of overlap between different macroprudential tools for targeting similar risks in this Regulation and Directive 2013/36/EU are adequate and, if appropriate, propose new macroprudential rules;
- (c) how internationally agreed standards for systemic institutions interacts with the provisions in this Regulation and Directive 2013/36/EU and, if appropriate, propose new rules taking into account those internationally agreed standards.

2. By 31 December 2014, the Commission shall, on the basis of the consultation with the ESRB and EBA, report to the European Parliament and the Council on the assessment referred to in paragraph 1 and, where appropriate, submit a legislative proposal to the European Parliament and the Council.

#### Article 514

##### Counterparty Credit Risk and the Original Exposure Method

By 31 December 2016 the Commission shall review and report on the application of Article 275 and shall submit that report to the European Parliament and the Council, and, if appropriate, a legislative proposal.

## Article 515

**Monitoring and evaluation**

1. EBA, together with ESMA, shall by 2 January 2015 report on the functioning of this Regulation with the related obligations under Regulation (EU) No 648/2012 and in particular with regard to institutions operating a central counterparty, in order to avoid duplication of requirements for derivative transactions and thereby avoid increased regulatory risk and increased costs for monitoring by competent authorities.

2. EBA shall monitor and evaluate the operation of the provisions for own funds requirements for exposures to a central counterparty as set out in Section 9 of Chapter 6 of Title II of Part Three. By 1 January 2015 EBA shall report to the Commission on the impact and effectiveness of such provisions.

3. By 31 December 2016 the Commission shall review and report on the reconciliation of this Regulation with the related obligations under Regulation (EU) No 648/2012, the own funds requirements as set out in Section 9 of Chapter 6 of Title II of Part Three and shall submit that report to the European Parliament and the Council, and, if appropriate, a legislative proposal.

## Article 516

**Long-term financing**

By 31 December 2015 the Commission shall report on the impact of this Regulation on the encouragement of long-term investments in growth promoting infrastructure.

## Article 517

**Definition of eligible capital**

By 31 December 2014 the Commission shall review and report on the appropriateness of the definition of eligible capital being applied for the purposes of Title III of Part Two and Part Four and shall submit that report to the European Parliament and the Council, and, if appropriate, a legislative proposal.

## Article 518

**Review of capital instruments which may be written down or converted at the point of non-viability**

By 31 December 2015, the Commission shall review and report on whether this Regulation should contain a requirement that Additional Tier 1 or Tier 2 capital instruments are to be written down in the event of a determination that an institution is no longer viable. The Commission shall submit that report to the European Parliament and the Council, together with a legislative proposal if appropriate.

## Article 519

**Deduction of defined benefit pension fund assets from Common Equity Tier 1 items**

EBA shall by 30 June 2014 prepare a report on whether the revised IAS 19 in conjunction with the deduction of net

pension assets as set out in Article 36(1)(e) and changes in the net pension liabilities lead to undue volatility of institutions' own funds.

Taking into account the EBA report, the Commission shall by 31 December 2014 prepare a report to the European Parliament and the Council on the issue referred to in the first paragraph, together with a legislative proposal, if appropriate, to introduce a treatment which adjusts defined net benefit pension fund assets or liabilities for the calculation of own funds.

## TITLE III

## AMENDMENTS

## Article 520

**Amendment of Regulation (EU) No 648/2012**

Regulation (EU) No 648/2012 is amended as follows:

(1) the following Chapter is added in Title IV:

## "CHAPTER 4

**Calculations and reporting for the purposes of Regulation (EU) No 575/2013**

## Article 50a

**Calculation of  $K_{CCP}$** 

1. For the purposes of Article 308 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (\*), where a CCP has received the notification referred to in Article 301(2)(b) of that Regulation, it shall calculate  $K_{CCP}$  as specified in paragraph 2 of this Article for all contracts and transactions it clears for all its clearing members falling within the coverage of the given default fund.

2. A CCP shall calculate the hypothetical capital ( $K_{CCP}$ ) as follows:

$$K_{CCP} = \sum_i \max\{EBRM_i - IM_i - DF_i; 0\} \cdot RW \cdot \text{capital ratio}$$

where:

$EBRM_i$  = exposure value before risk mitigation that is equal to the exposure value of the CCP to clearing member  $i$  arising from all the contracts and transactions with that clearing member, calculated without taking into account the collateral posted by that clearing member;



$IM_i$  = 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 %.

3. A CCP shall undertake the calculation required by paragraph 2 at least quarterly or more frequently where required by the competent authorities of those of its clearing members which are institutions.

4. EBA shall develop draft implementing technical standards to specify the following for the purpose of paragraph 3:

- (a) the frequency and dates of the calculation laid down in paragraph 2;
- (b) the situations in which the competent authority of an institution acting as a clearing member may require higher frequencies of calculation and reporting than those referred to in point (a).

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 Article 15 of Regulation (EU) No 1093/2010.

#### Article 50b

##### General rules for the calculation of $K_{CCP}$

For the purposes of the calculation laid down in Article 50a(2), the following shall apply:

- (a) a CCP shall calculate the value of the exposures it has to its clearing members as follows:
  - (i) for exposures arising from contracts and transactions listed in Article 301(1)(a) and (d) of Regulation (EU) No 575/2013;
  - (ii) for exposures arising from contracts and transactions listed in Article 301(1)(b), (c) and (e) of Regulation (EU) No 575/2013 it shall calculate them in accordance with the Financial Collateral Comprehensive Method specified in Article 223 of that Regulation with supervisory volatility adjustments, specified in Articles 223 and 224 of that Regulation. The exception set out in point (a) of Article 285(3) of that Regulation, shall not apply;
  - (iii) for exposures arising from transactions not listed in Article 301(1) of Regulation (EU) No 575/2013

and which entails settlement risk only it shall calculate them in accordance with Part Three, Title V of that Regulation;

- (b) for institutions that fall under the scope of Regulation (EU) No 575/2013 the netting sets are the same as those defined in Part Three, Title II of that Regulation;
- (c) when calculating the values referred to in point (a), 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 224 of Regulation (EU) No 575/2013;
- (d) a CCP shall calculate its securities financing transaction exposures to its clearing members in accordance with the Financial Collateral Comprehensive method, with supervisory volatility adjustments, specified in Articles 223 and 224 of Regulation (EU) No 575/2013;
- (e) 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  $K_{CCP}$ ;
- (f) where a CCP has in place a binding contractual arrangement with its clearing members that allows it to use all or part of the initial margin received from its clearing members as if they were pre-funded contributions, the CCP shall consider that initial margin as prefunded contributions for the purposes of the calculation in paragraph 1 and not as initial margin;
- (g) when applying the Mark-to-Market Method, a CCP shall replace the formula in point (c)(ii) of Article 298(1) of Regulation (EU) No 575/2013 with the following:

$$PCE_{red} = 0.15 \cdot PCE_{gross} + 0.85 \cdot NGR \cdot PCE_{gross};$$

where the numerator of NGR is calculated in accordance with Article 274(1) of Regulation (EU) No 575/2013 and just before the variation margin is actually exchanged at the end of the settlement period, and the denominator is the gross replacement cost;

- (h) when applying the Mark-to-Market Method as set out in Article 274 of Regulation (EU) No 575/2013, a CCP shall replace the formula in point (c)(ii) of Article 298(1) of that Regulation with the following:

$$PCE_{red} = 0.15 \cdot PCE_{gross} + 0.85 \cdot NGR \cdot PCE_{gross}$$

where the numerator of NGR is calculated in accordance with Article 274(1) of that Regulation and just before variation margins are actually exchanged at the end of the settlement period, and the denominator is gross replacement cost;

(i) where a CCP cannot calculate the value of NGR as set out in point (c)(ii) of Article 298(1) of Regulation (EU) No 575/2013, it shall:

(i) notify those of its clearing members which are institutions and their competent authorities about its inability to calculate NGR and the reasons why it is unable to carry out the calculation;

(ii) for a period of three months, it may use a value of NGR of 0,3 to perform the calculation of  $PCE_{red}$  specified in point (g);

(j) where, at the end of the period specified in point (ii) of point (i), 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 and their competent authorities that it has stopped calculating  $K_{CCP}$ ;

(k) for the purpose of calculating the potential future exposure for options and swaptions in accordance with the Mark-to-Market Method specified in Article 274 of Regulation (EU) No 575/2013, a CCP shall multiply the notional amount of the contract by the absolute value of the option's delta ( $\delta V/\delta p$ ) as set out in point (a) of Article 280(1) of that Regulation;

(l) where a CCP has more than one default fund, it shall carry out the calculation laid down in Article 50a(2) for each default fund separately.

#### Article 50c

##### Reporting of information

1. For the purposes of Article 308 of Regulation (EU) No 575/2013, a CCP shall report 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) the total number of its clearing members (N);

(e) the concentration factor ( $\beta$ ), as set out in Article 50d;

(f) the sum of all of the contractually committed contributions ( $DF_{CM}^c$ ).

Where the CCP has more than one default fund, it shall report the information in the first subparagraph for each default fund separately.

2. 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.

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

(a) the uniform template for the purpose of the reporting specified in paragraph 1;

(b) the frequency and dates of the reporting specified in paragraph 2;

(c) the situations in which the competent authority of an institution acting as a clearing member may require higher frequencies of reporting than those referred to in point (b).

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 Article 15 of Regulation (EU) No 1093/2010.

#### Article 50d

##### Calculation of specific items to be reported by the CCP

For the purposes of Article 50c, the following shall apply:

(a) where the rules of a CCP provide that it use part or all of its financial resources in parallel to the pre-funded contributions of its clearing members in a manner that makes those resources equivalent to pre-funded contributions of a clearing member in terms of how they absorb the losses incurred by the CCP in the case of the default or insolvency of one or more of its clearing members, the CCP shall add the corresponding amount of those resources to  $DF_{CM}$ ;

- (b) where the rules of a CCP provide that it use part or all 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 corresponding amount of those additional financial resources ( $DF_{CCP}^a$ ) to the total amount of pre-funded contributions (DF) as follows:

$$DF = DF_{CCP} + DF_{CM} + DF_{CCP}^a.$$

- (c) a CCP shall calculate the concentration factor ( $\beta$ ) in accordance with the following formula:

$$\beta = \frac{PCE_{red,1} + PCE_{red,2}}{\sum_i PCE_{red,i}}$$

where:

$PCE_{red,i}$  = the reduced figure for potential future credit exposure for all contracts and transaction of a CCP with clearing member  $i$ ;

$PCE_{red,1}$  = the reduced figure for potential future credit exposure for all contracts and transaction of a CCP with the clearing member that has the largest  $PCE_{red}$  value;

$PCE_{red,2}$  = the reduced figure for potential future credit exposure for all contracts and transaction of a CCP with the clearing member that has the second largest  $PCE_{red}$  value.

(\*) OJ L 176, 27.6.2013, p. 1.;

- (2) in Article 11(15), point (b) is deleted;

- (3) in Article 89, the following paragraph is inserted:

"5a. Up until 15 months after the date of entry into force of the latest of the eleven regulatory technical standards referred to at the end of the first subparagraph of paragraph 3, or until a decision is made under Article 14

on the authorisation of the CCP, whichever date is earlier, that CCP shall apply the treatment specified in the third subparagraph of this paragraph.

Up until 15 months after the date of entry into force of the latest of the eleven regulatory technical standards referred to at the end of the second subparagraph of paragraph 3, or until a decision is made under Article 25 on the recognition of the CCP, whichever date is earlier, that CCP shall apply the treatment specified in the third subparagraph of this paragraph.

Where a CCP does not have a default fund and it does not have in place a binding arrangement with its clearing members that allows it to use all or part of the initial margin received from its clearing members as if they were pre-funded contributions, the information it shall report in accordance with Article 50c(1) shall include the total amount of initial margin it has received from its clearing members (IM).

The deadlines in the first and second subparagraphs of this paragraph may be extended by an additional six months where the Commission has adopted the implementing act referred to in Article 497(3) of Regulation (EU) No 575/2013."

## PART ELEVEN

### FINAL PROVISIONS

#### Article 521

#### Entry into force and date of application

1. This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.
2. This Regulation shall apply from 1 January 2014, with the exception of:
  - (a) Article 8(3), Article 21 and Article 451(1), which shall apply from 1 January 2015;
  - (b) Article 413(1), which shall apply from 1 January 2016;
  - (c) the provisions of this Regulation that require the ESAs to submit to the Commission draft technical standards and the provisions of this Regulation that empower the Commission to adopt delegated acts or implementing acts, which shall apply from 31 December 2014.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 26 June 2013.

For the European Parliament  
The President  
M. SCHULZ

For the Council  
The President  
A. SHATTER

## ANNEX I

**Classification of off-balance sheet items**

## 1. Full risk:

- (a) guarantees having the character of credit substitutes, (e.g. guarantees for the good payment of credit facilities);
- (b) credit derivatives;
- (c) acceptances;
- (d) endorsements on bills not bearing the name of another institution;
- (e) transactions with recourse (e.g. factoring, invoice discount facilities);
- (f) irrevocable standby letters of credit having the character of credit substitutes;
- (g) assets purchased under outright forward purchase agreements;
- (h) forward deposits;
- (i) the unpaid portion of partly-paid shares and securities;
- (j) asset sale and repurchase agreements as referred to in Article 12(3) and (5) of Directive 86/635/EEC;
- (k) other items also carrying full risk.

## 2. Medium risk:

- (a) trade finance off-balance sheet items, namely documentary credits issued or confirmed (see also 'Medium/low risk');
- (b) other off-balance sheet items:
  - (i) shipping guarantees, customs and tax bonds;
  - (ii) undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year;
  - (iii) note issuance facilities (NIFs) and revolving underwriting facilities (RUFs);
  - (iv) other items also carrying medium risk and as communicated to EBA.

## 3. Medium/low risk:

- (a) trade finance off-balance sheet items:
  - (i) documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions;
  - (ii) warranties (including tender and performance bonds and associated advance payment and retention guarantees) and guarantees not having the character of credit substitutes;
  - (iii) irrevocable standby letters of credit not having the character of credit substitutes;
- (b) other off-balance sheet items:
  - (i) 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;
  - (ii) other items also carrying medium/low risk and as communicated to EBA.

4. Low risk:

- (a) 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;
  - (b) undrawn credit facilities for tender and performance guarantees 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; and
  - (c) 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) of this Annex 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 point 1 or 2 of this Annex.
-

## ANNEX III

**Items subject to supplementary reporting of liquid assets**

1. Cash.
2. Central bank exposures, to the extent that these exposures can be drawn down in times of stress.
3. Transferable securities representing claims on or claims guaranteed by sovereigns, central banks, non-central government public sector entities, regions with fiscal autonomy to raise and collect taxes and local authorities, the Bank for International Settlements, the International Monetary Fund, the European Union, the European Financial Stability Facility, the European Stability Mechanism or multilateral development banks and satisfying all of the following conditions:
  - (a) they are assigned a 0 % risk-weight under Chapter 2, Title II of Part Three;
  - (b) 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, non-central government public sector entities, regions with fiscal autonomy to raise and collect taxes and local authorities, or multilateral development banks and satisfying all of the following conditions:
  - (a) they are assigned a 20 % risk-weight under Chapter 2, Title II of Part Three;
  - (b) 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, 4 and 5 that qualify for a 20 % or better risk weight under Chapter 2, Title II of Part Three 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 eligible for the treatment set out in Article 129(4) or (5);
  - (c) they are bonds as referred to in Article 52(4) of Directive 2009/65/EC other than those referred to in point (b) of this point.
7. Transferable securities other than those referred to in points 3 to 6 that qualify for a 50 % or better risk weight under Chapter 2, Title II of Part Three or are internally rated as having an equivalent credit quality, and do not represent a claim on an SSPE, an institution or any of its affiliated entities.
8. Transferable securities other than those referred to in points 3 to 7 that are collateralised by assets that qualify for a 35 % or better risk weight under Chapter 2, Title II of Part Three or are internally rated as having an equivalent credit quality, and are fully and completely secured by mortgages on residential property in accordance with Article 125.
9. Standby credit facilities granted by central banks within the scope of monetary policy to the extent that these facilities are not collateralised by liquid assets and excluding emergency liquidity assistance.
10. Legal or statutory minimum deposits with the central credit institution and other statutory or contractually available liquid funding from the central credit institution or institutions that are members of the network referred to in Article 113(7), or eligible for the waiver provided in Article 10, to the extent that this funding is not collateralised by liquid assets, if the credit institution belongs to a network in accordance with legal or statutory provisions.

11. Exchange traded, centrally cleared common equity shares, that are a constituent of a major stock index, denominated in the domestic currency of the Member State and not issued by an institution or any of its affiliates.
12. Gold listed on a recognised exchange, held on an allocated basis.

All items with the exception of those referred to in points 1, 2 and 9 must satisfy all of the following conditions:

- (a) they are traded in simple repurchase agreements or cash markets characterised by a low level of concentration;
  - (b) they have a proven record as a reliable source of liquidity by either repurchase agreement or sale even during stressed market conditions;
  - (c) they are unencumbered.
-

## ANNEX IV

## Correlation table

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# DIRECTIVES

## DIRECTIVE 2013/36/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 26 June 2013

**on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC**

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Annexes to Directives 2006/48/EC and 2006/49/EC should be integrated into the enacting terms of this Directive and of that Regulation.

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 53(1) 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 Central Bank <sup>(1)</sup>,

Acting in accordance with the ordinary legislative procedure,

Whereas:

(1) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions <sup>(2)</sup> and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions <sup>(3)</sup> 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. For the sake of clarity and in order to ensure a coherent application of those provisions, they should be merged into new legislative acts that are applicable to both credit institutions and investment firms, namely this Directive and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 <sup>(4)</sup>. For greater accessibility, the provisions of the

(2) This Directive should, inter alia, contain the 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. The main objective and subject-matter of this Directive is to coordinate national provisions concerning access to the activity of credit institutions and investment firms, the modalities for their governance, and their supervisory framework. Directives 2006/48/EC and 2006/49/EC also contained prudential requirements for credit institutions and investment firms. Those requirements should be provided for in Regulation (EU) No 575/2013, which establishes uniform and directly applicable prudential requirements for credit institutions and investment firms, since such requirements are closely related to the functioning of financial markets in respect of a number of assets held by credit institutions and investment firms. This Directive should therefore be read together with Regulation (EU) No 575/2013 and should, together with that Regulation, form the legal framework governing banking activities, the supervisory framework and the prudential rules for credit institutions and investment firms.

(3) The general prudential requirements laid down in Regulation (EU) No 575/2013 are supplemented by individual arrangements to be decided by the competent authorities as a result of their ongoing supervisory review of each individual credit institution and investment firm. The range of such supervisory arrangements should, inter alia, be set out in this Directive and the competent authorities should be able to exercise their judgment as to which arrangements should be imposed. With regard to such individual arrangements concerning liquidity, the competent authorities should, inter alia, take into account the principles set out in the Committee of European Banking Supervisors' Guidelines on Liquidity Cost Benefit Allocation of 27 October 2010.

<sup>(1)</sup> OJ C 105, 11.4.2012, p. 1.

<sup>(2)</sup> OJ L 177, 30.6.2006, p. 1.

<sup>(3)</sup> OJ L 177, 30.6.2006, p. 201.

<sup>(4)</sup> See page 1 of this Official Journal.

- (4) Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments <sup>(1)</sup> allows investment firms authorised by the competent authorities of their home Member State and supervised by the same authorities to establish branches and provide services freely in other Member States. That Directive accordingly provides for the coordination of the rules governing the authorisation and pursuit of the business of investment firms. It does not, however, establish the amounts of the initial capital of such firms or a common framework for monitoring the risks incurred by them, which should be provided by this Directive.
- (5) This Directive should constitute the essential instrument for the achievement of the internal market from the point of view of both the freedom of establishment and the freedom to provide financial services in the field of credit institutions.
- (6) The smooth operation of the internal market requires not only legal rules but also close and regular cooperation and significantly enhanced convergence of regulatory and supervisory practices between the competent authorities of the Member States.
- (7) Regulation (EU) No 1093/2010 of the European Parliament and of the Council <sup>(2)</sup> established the European Supervisory Authority (European Banking Authority) ("EBA"). This Directive should take into account the role and function of EBA set out in that Regulation and the procedures to be followed when conferring tasks on EBA.
- (8) Given the increase of tasks conferred on EBA by this Directive and by Regulation (EU) No 575/2013, the European Parliament, the Council and the Commission should ensure that adequate human and financial resources are made available.
- (9) As a first step towards a banking union, a single supervisory mechanism (SSM) should ensure that the Union's policy relating to the prudential supervision of credit institutions is implemented in a coherent and effective manner, that the single rulebook for financial services is applied in the same manner to credit institutions in all Member States concerned, and that those credit institutions are subject to supervision of the highest quality, unfettered by other, non-prudential considerations. An SSM is the basis for the next steps towards a banking union. This reflects the principle that any introduction of common intervention mechanisms in the event of a crisis should be preceded by common controls to reduce the likelihood that such intervention mechanisms will have to be used. The European Council noted in its conclusions of 14 December 2012 that "the Commission will submit in the course of 2013 a proposal for a single resolution mechanism for Member States participating in the SSM, to be examined by co-legislators as a matter of priority with the intention of adopting it during the current parliamentary cycle". The integration of the financial framework could be further enhanced through the setting up of a single resolution mechanism, including appropriate and effective backstop arrangements to ensure that bank resolution decisions are taken swiftly, impartially and in the best interests of all concerned.
- (10) The conferral of supervisory tasks on the European Central Bank (ECB) for some of the Member States should be consistent with the framework of the European System of Financial Supervision set up in 2010 and its underlying objective to develop the single rulebook and enhance convergence of supervisory practices across the Union as a whole. The ECB should carry out its tasks subject to and in compliance with any relevant primary and secondary Union law, Commission decisions in the areas of State aid, competition rules and merger control and the single rulebook applying to all Member States. EBA is entrusted with developing draft technical standards and guidelines and recommendations to ensure supervisory convergence and consistency of supervisory outcomes within the Union. The ECB should not carry out those tasks, but should exercise powers to adopt regulations under Article 132 of the Treaty on the Functioning of the European Union (TFEU) in accordance with acts adopted by the Commission on the basis of drafts developed by EBA and with guidelines and recommendation under Article 16 of Regulation (EU) No 1093/2010.
- (11) EBA's legally binding mediation role is a key element of the promotion of coordination, supervisory consistency and convergence of supervisory practices. Mediation by EBA can be initiated either on its own initiative where specifically provided for, or upon request by one or more competent authorities in the event of a disagreement. This Directive and Regulation (EU) No 575/2013 should extend the range of situations in which EBA can initiate its legally binding mediation role with a view to contributing to consistency in supervisory practices. EBA has no own-initiative mediation role with regard to the designation of significant branches and the determination of institution-specific prudential requirements under this Directive. However, in order to promote coordination and enhance consistent supervisory practices in those sensitive areas, competent authorities should have recourse to EBA mediation at an early stage of the process in the event of a disagreement. Such early EBA mediation should facilitate finding a resolution to the disagreement.

<sup>(1)</sup> OJ L 145, 30.4.2004, p. 1.

<sup>(2)</sup> OJ L 331, 15.12.2010, p. 12.

- (12) In order to protect savings and to create equal conditions of competition between credit institutions, measures to coordinate the supervision of credit institutions should apply to all of them. Due regard should, however, be had to the objective differences in their statutes and aims as laid down in national law.
- (13) In order to ensure a well-functioning internal market, transparent, predictable and harmonised supervisory practices and decisions are necessary for conducting business and steering cross-border groups of credit institutions. EBA should therefore enhance harmonisation of supervisory practices. Supervisory processes and decisions should not hamper the functioning of the internal market with regard to the free flow of capital. Supervisory colleges should ensure a common and aligned work programme and harmonised supervisory decisions. Cooperation between the competent authorities of the home and host Member States should be strengthened through a higher degree of transparency and information sharing.
- (14) The scope of measures should therefore be as broad as possible, covering all institutions whose business is to receive repayable funds from the public, whether in the form of deposits or in other forms such as the continuing issue of bonds and other comparable securities and to grant credits for their own account. Exceptions should be provided for in the case of certain credit institutions to which this Directive does not apply. This Directive should not affect the application of national laws which provide for special supplementary authorisations permitting credit institutions to carry out specific activities or undertake specific kinds of operations.
- (15) It is appropriate to effect harmonisation which is necessary and sufficient to secure the mutual recognition of authorisation and of prudential supervision systems, making possible the granting of a single licence recognised throughout the Union and the application of the principle of home Member State prudential supervision.
- (16) The principles of mutual recognition and home Member State supervision require that Member States' competent authorities should refuse or withdraw authorisation where factors such as the content of the activities programme, the geographical distribution of activities or the activities actually carried out indicate clearly that a credit institution has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within whose territory it carries out or intends to carry out the greater part of its activities. Where there is no such clear indication, but the majority of the total assets of the entities in a banking group is located in another Member State, the competent authorities of which are responsible for exercising supervision on a consolidated basis, responsibility for exercising supervision on a consolidated basis should be changed only with the agreement of those competent authorities.
- (17) The competent authorities should not authorise or continue to authorise a credit institution where they are liable to be prevented from effectively exercising their supervisory functions by the close links between that institution and other natural or legal persons. Credit institutions already authorised should also satisfy the competent authorities in respect of such close links.
- (18) The reference to the supervisory authorities' effective exercise of their supervisory functions covers supervision on a consolidated basis which should be exercised over a credit institution or investment firm where Union law so provides. In such cases, the authorities applied to for authorisation should be able to identify the authorities competent to exercise supervision on a consolidated basis over that credit institution or investment firm.
- (19) Credit institutions authorised in their home Member States should be allowed to carry out throughout the Union any or all of the activities referred to in the list of activities subject to mutual recognition by establishing branches or by providing services.
- (20) It is appropriate to extend mutual recognition to those activities where they are carried out by financial institutions which are subsidiaries of credit institutions, provided that such subsidiaries are covered by the consolidated supervision of their parent undertakings and meet certain strict conditions.
- (21) The host Member State should be able, in connection with the exercise of the right of establishment and the freedom to provide services, to require compliance with specific provisions of its own national laws or regulations on the part of entities not authorised as credit institutions in their home Member States and with regard to activities not referred to in the list of activities subject to mutual recognition, provided that, on the one hand, such provisions are not already provided for in Regulation (EU) No 575/2013, are compatible with Union law and are intended to protect the general good and that, on the other, such entities or such activities are not subject to equivalent rules under the laws or regulations of their home Member States.
- (22) In addition to Regulation (EU) No 575/2013 which establishes directly applicable prudential requirements for credit institutions and investment firms, Member States should ensure that there are no obstacles to carrying out activities receiving mutual recognition in the same manner as in the home Member State, provided that the latter do not conflict with legal provisions protecting the general good in the host Member State.

- (23) The rules governing branches of credit institutions having their head office in a third country should be analogous in all Member States. It is important to provide that such rules are not more favourable than those applicable to branches of credit institutions from another Member State. The Union should be able to conclude agreements with third countries providing for the application of rules which accord such branches the same treatment throughout its territory. Branches of credit institutions authorised in third countries should not enjoy the freedom to provide services or the freedom of establishment in Member States other than those in which they are established.
- (24) Agreement should be reached between the Union and third countries with a view to allowing the practical exercise of consolidated supervision over the largest possible geographical area.
- (25) Responsibility for supervising the financial soundness of a credit institution and in particular its solvency on a consolidated basis should lie with its home Member State. The supervision of Union banking groups should be the subject of close cooperation between the competent authorities of the home and host Member States.
- (26) The competent authorities of host Member States should have the power to carry out, on a case-by-case basis, on-the-spot checks and inspections of the activities of branches of institutions on their territory and require information from a branch about its activities and for statistical, informational, or supervisory purposes, where the host Member States consider it relevant for reasons of stability of the financial system.
- (27) The competent authorities of the host Member States should obtain information about activities carried out in their territories. Supervisory measures should be taken by the competent authorities of the home Member State unless the competent authorities of the host Member States have to take precautionary emergency measures.
- (28) The smooth operation of the internal banking market requires not only legal rules but also close and regular cooperation and significantly enhanced convergence of regulatory and supervisory practices between the competent authorities of the Member States. To that end, consideration of problems concerning individual credit institutions and the mutual exchange of information should take place through EBA. That mutual information procedure should not replace bilateral cooperation. Competent authorities of the host Member States should always be able, in an emergency, on their own initiative or on the initiative of the competent authorities of the home Member State, to check that the activities of a credit institution established within their territories comply with the relevant laws and with the principles of sound administrative and accounting procedures and adequate internal control.
- (29) It is appropriate to allow the exchange of information between the competent authorities and authorities or bodies which, by virtue of their function, help to strengthen the stability of the financial system. In order to preserve the confidential nature of the information forwarded, the list of addressees should be strictly limited.
- (30) Certain behaviour, such as fraud or insider dealing, is liable to affect the stability and the integrity of the financial system. It is necessary to specify the conditions under which exchange of information in such cases is authorised.
- (31) Where it is stipulated that information may be disclosed only with the express agreement of the competent authorities, the competent authorities should be able to make their agreement subject to compliance with strict conditions.
- (32) Exchanges of information should be authorised between the competent authorities and central banks and other bodies with a similar function in their capacity as monetary authorities and, where necessary for reasons of prudential supervision, prevention and resolution of failing institutions and in emergency situations, if relevant, other public authorities and departments of central government administrations responsible for drawing up legislation on the supervision of credit institutions, financial institutions, investment services and insurance companies, and public authorities responsible for supervising payment systems.
- (33) For the purposes of strengthening the prudential supervision of institutions and the protection of clients of institutions, auditors should have a duty to report promptly to the competent authorities, wherever, during the performance of their tasks, they become aware of certain facts which are liable to have a serious effect on the financial situation or the administrative and accounting organisation of an institution. For the same reason Member States should also provide that such a duty applies in all circumstances where such facts are discovered by an auditor during the performance of his tasks in an undertaking which has close links with an institution. The duty of auditors to communicate, where appropriate, to the competent authorities certain facts and decisions concerning an institution which they discover during the performance of their tasks in a non-financial undertaking should not in itself change the nature of their tasks in that undertaking nor the manner in which they should perform those tasks in that undertaking.



- (34) This Directive and Regulation (EU) No 575/2013 aim to ensure the solvency of institutions. If, notwithstanding the solvency requirements, a crisis occurs, it is necessary to ensure that institutions can be resolved in an orderly manner, limiting the negative impact on the real economy and avoiding the need for taxpayers to step in. For that purpose, pending further coordination at Union level, EBA should assess and coordinate initiatives, in accordance with Regulation (EU) No 1093/2010, on recovery and resolution plans with a view to promoting convergence in that area. To that end, EBA should be fully informed in advance of the organisation of meetings on recovery and resolution plans and should be entitled to participate in such meetings. Some Member States' authorities have already introduced obligations for institutions and authorities to prepare recovery and resolution plans. It is therefore appropriate that institutions be required to cooperate with authorities in that regard. Where a recovery or resolution plan is being drafted, EBA should contribute to and participate actively in the development and coordination of effective and consistent recovery and resolution plans in accordance with Regulation (EU) No 1093/2010. Priority should be given where such plans involve systemically important institutions.
- (35) In order to ensure compliance with the obligations deriving from this Directive and from Regulation (EU) No 575/2013 by institutions, by those who effectively control the business of an institution and by the members of an institution's management body, and to ensure similar treatment across the Union, Member States should be required to provide for administrative penalties and other administrative measures which are effective, proportionate and dissuasive. Therefore, administrative penalties and other administrative measures laid down by Member States should satisfy certain essential requirements in relation to addressees, the criteria to be taken into account in their application, their publication, key powers to impose penalties and levels of administrative pecuniary penalties.
- (36) In particular, competent authorities should be empowered to impose administrative pecuniary penalties which are sufficiently high to offset the benefits that can be expected and to be dissuasive even to larger institutions and their managers.
- (37) In order to ensure a consistent application of administrative penalties or other administrative measures across Member States, when determining the type of administrative penalties or other administrative measures and the level of administrative pecuniary penalties Member States should be required to ensure that the competent authorities take into account all relevant circumstances.
- (38) In order to ensure that administrative penalties have a dissuasive effect, they should normally be published except in certain well-defined circumstances.
- (39) For the purposes of assessing the good repute of directors and members of a management body, an efficient system of exchange of information is required where EBA, subject to professional secrecy and data protection requirements, should be entitled to maintain a central database containing details of administrative penalties, including any appeals in relation thereto, which is accessible to competent authorities only. In any event, information about criminal convictions should be exchanged in accordance with Framework Decision 2009/315/JHA <sup>(1)</sup> and Decision 2009/316/JHA <sup>(2)</sup>, as transposed into national law, and with other relevant provisions of national law.
- (40) In order to detect potential breaches of national provisions transposing this Directive and of Regulation (EU) No 575/2013, competent authorities should have the necessary investigatory powers and should establish effective mechanisms to encourage reporting of potential or actual breaches. Those mechanisms should be without prejudice to the rights of the defence of anyone who has been charged.
- (41) This Directive should provide for administrative penalties and other administrative measures in order to ensure the greatest possible scope for action following a breach and to help prevent further breaches, irrespective of their qualification as an administrative penalty or other administrative measure under national law. Member States should be able to provide for additional penalties to, and higher level of administrative pecuniary penalties than, those provided for in this Directive.
- (42) This Directive should be without prejudice to any provisions in the law of Member States relating to criminal penalties.
- (43) Member States should ensure that credit institutions and investment firms have internal capital that, having regard to the risks to which they are or may be exposed, is adequate in quantity, quality and distribution. Accordingly, Member States should ensure that credit institutions and investment firms have strategies and processes in place for assessing and maintaining the adequacy of their internal capital.

<sup>(1)</sup> Council Framework Decision 2009/315/JHA of 26 February 2009 on the organisation and content of the exchange of information extracted from the criminal record between Member States (OJ L 93, 7.4.2009, p. 23).

<sup>(2)</sup> Council Decision 2009/316/JHA of 6 April 2009 on the establishment of the European Criminal Records Information System (ECRIS) in application of Article 11 of Framework Decision 2009/315/JHA (OJ L 93, 7.4.2009, p. 33).

- (44) Competent authorities should be entrusted with ensuring that institutions have a good organisation and adequate own funds, having regard to the risks to which the institutions are or might be exposed.
- (45) To ensure that institutions which are active in several Member States are not disproportionately burdened as a result of the continued responsibilities of individual Member State competent authorities as regards authorisation and supervision, it is essential to significantly enhance the cooperation between competent authorities. EBA should facilitate and enhance such cooperation.
- (46) In order to ensure comprehensive market discipline across the Union, it is appropriate that competent authorities publish information concerning the carrying out of the business of credit institutions and investment firms. Such information should be sufficient to enable a comparison of the approaches adopted by the different competent authorities of the Member States and complement requirements found in Regulation (EU) No 575/2013 regarding disclosure of technical information by institutions.
- (47) Supervision of institutions on a consolidated basis aims to protect the interests of depositors and investors of institutions and to ensure the stability of the financial system. In order to be effective, supervision on a consolidated basis should therefore be applied to all banking groups, including those the parent undertakings of which are not credit institutions or investment firms. Member States should provide competent authorities with the necessary legal instruments to enable them to exercise such supervision.
- (48) In the case of groups with diversified activities where parent undertakings control at least one subsidiary, the competent authorities should be able to assess the financial situation of each credit institution or investment firm in such a group. The competent authorities should at least have the means of obtaining from all undertakings within a group the information necessary for the performance of their function. Cooperation between the authorities responsible for the supervision of different financial sectors should be established in the case of groups of undertakings carrying out a range of financial activities.
- (49) Member States should be able to refuse or withdraw a credit institution's authorisation in the case of certain group structures considered inappropriate for carrying out banking activities, because such structures cannot be supervised effectively. In that respect the competent authorities should have the necessary powers to ensure the sound and prudent management of credit institutions. In order to secure a sustainable and diverse Union banking culture which primarily serves the interest of the citizens of the Union, small-scale banking activities, such as those of credit unions and cooperative banks, should be encouraged.
- (50) The mandates of competent authorities should take into account, in an appropriate manner, the Union dimension. Competent authorities should therefore duly consider the effect of their decisions not only on the stability of the financial system in their jurisdiction but also in all other Member States concerned. Subject to national law, that principle should serve to promote financial stability across the Union and should not legally bind competent authorities to achieve a specific result.
- (51) The financial crisis demonstrated links between the banking sector and so-called 'shadow banking'. Some shadow banking usefully keeps risks separate from the banking sector and hence avoids potential negative effects on taxpayers and systemic impact. Nevertheless, a fuller understanding of shadow banking operations and their links to financial sector entities, and tighter regulation to provide transparency, a reduction of systemic risk and the elimination of any improper practices are necessary for the stability of the financial system. Additional reporting from institutions can establish some of this but specific new regulation is also necessary.
- (52) Increased transparency regarding the activities of institutions, and in particular regarding profits made, taxes paid and subsidies received, is essential for regaining the trust of citizens of the Union in the financial sector. Mandatory reporting in that area can therefore be seen as an important element of the corporate responsibility of institutions towards stakeholders and society.
- (53) Weaknesses in corporate governance in a number of institutions have contributed to excessive and imprudent risk-taking in the banking sector which has led to the failure of individual institutions and systemic problems in Member States and globally. The very general provisions on governance of institutions and the non-binding nature of a substantial part of the corporate governance framework, based essentially on voluntary codes of conduct, did not sufficiently facilitate the effective implementation of sound corporate governance practices by institutions. In some cases, the absence of effective checks and balances within institutions resulted in a lack of effective oversight of management decision-making, which exacerbated short-term and excessively risky management strategies. The unclear role of the competent authorities in overseeing corporate governance systems in institutions did not allow for sufficient supervision of the effectiveness of the internal governance processes.

- (54) In order to address the potentially detrimental effect of poorly designed corporate governance arrangements on the sound management of risk, Member States should introduce principles and standards to ensure effective oversight by the management body, promote a sound risk culture at all levels of credit institutions and investment firms and enable competent authorities to monitor the adequacy of internal governance arrangements. Those principles and standards should apply taking into account the nature, scale and complexity of institutions' activities. Member States should be able to impose corporate governance principles and standards additional to those required by this Directive.
- (55) Different governance structures are used across Member States. In most cases a unitary or a dual board structure is used. The definitions used in this Directive are intended to embrace all existing structures without advocating any particular structure. They are purely functional for the purpose of setting out rules aimed at a particular outcome irrespective of the national company law applicable to an institution in each Member State. The definitions should therefore not interfere with the general allocation of competences in accordance with national company law.
- (56) A management body should be understood to have executive and supervisory functions. The competence and structure of management bodies differ across Member States. In Member States where management bodies have a one-tier structure, a single board usually performs management and supervisory tasks. In Member States with a two-tier system, the supervisory function is performed by a separate supervisory board which has no executive functions and the executive function is performed by a separate management board which is responsible and accountable for the day-to-day management of the undertaking. Accordingly, separate tasks are assigned to the different entities within the management body.
- (57) The role of non-executive members of the management body within an institution should include constructively challenging the strategy of the institution and thereby contributing to its development, scrutinising the performance of management in achieving agreed objectives, satisfying themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible, scrutinising the design and implementation of the institution's remuneration policy and providing objective views on resources, appointments and standards of conduct.
- (58) In order to monitor management actions and decisions effectively, the management body of an institution should commit sufficient time to allow it to perform its functions and to be able to understand the business of the institution, its main risk exposures and the implications of the business and the risk strategy. Combining too high a number of directorships would preclude a member of the management body from spending adequate time on the performance of that oversight role. Therefore, it is necessary to limit the number of directorships a member of the management body of an institution may hold at the same time in different entities. However, directorships in organisations which do not pursue predominantly commercial objectives, such as non-profit-making or charitable organisations, should not be taken into account for the purposes of applying such a limit.
- (59) When appointing members of the management body, the shareholders or members of an institution should consider whether the candidates have the knowledge, qualifications and skills necessary to safeguard proper and prudent management of the institution. Those principles should be exercised and manifested through transparent and open appointment procedures, with regard to members of the management body.
- (60) The lack of monitoring by management bodies of management decisions is partly due to the phenomenon of 'groupthink'. This phenomenon is, inter alia, caused by a lack of diversity in the composition of management bodies. To facilitate independent opinions and critical challenge, management bodies of institutions should therefore be sufficiently diverse as regards age, gender, geographical provenance and educational and professional background to present a variety of views and experiences. Gender balance is of particular importance to ensure adequate representation of population. In particular, institutions not meeting a threshold for representation of the underrepresented gender should take appropriate action as a matter of priority. Employee representation in management bodies could also, by adding a key perspective and genuine knowledge of the internal workings of institutions, be seen as a positive way of enhancing diversity. More diverse management bodies should more effectively monitor management and therefore contribute to improved risk oversight and resilience of institutions. Therefore, diversity should be one of the criteria for the composition of management bodies. Diversity should also be addressed in institutions' recruitment policy more generally. Such a policy should, for instance, encourage institutions to select candidates from shortlists including both genders.
- (61) In order to strengthen legal compliance and corporate governance, Member States should establish effective and reliable mechanisms to encourage reporting to competent authorities of potential or actual breaches of national provisions transposing this Directive and of Regulation (EU) No 575/2013. Employees reporting breaches committed within their own institutions should be fully protected.

- (62) Remuneration policies which encourage excessive risk-taking behaviour can undermine sound and effective risk management of credit institutions and investment firms. Members of the G-20 committed themselves to implementing the Financial Stability Board (FSB) Principles for Sound Compensation Practices and Implementing Standards, which address the potentially detrimental effect of poorly designed remuneration structures on the sound management of risk and control of risk-taking behaviour by individuals. This Directive aims to implement international principles and standards at Union level by introducing an express obligation for credit institutions and investment firms to establish and maintain, for categories of staff whose professional activities have a material impact on the risk profile of credit institutions and investment firms, remuneration policies and practices that are consistent with effective risk management.
- (63) In order to ensure that institutions have in place sound remuneration policies, it is appropriate to specify clear principles on governance and on the structure of remuneration policies. In particular, remuneration policies should be aligned with the risk appetite, values and long-term interests of the credit institution or investment firm. For that purpose, the assessment of the performance-based component of remuneration should be based on long-term performance and take into account the current and future risks associated with that performance.
- (64) When considering the policy on variable remuneration a distinction should be made between fixed remuneration, which includes payments, proportionate regular pension contributions, or benefits (where such benefits are without consideration of any performance criteria), and variable remuneration, which includes additional payments, or benefits depending on performance or, in exceptional circumstances, other contractual elements but not those which form part of routine employment packages (such as healthcare, child care facilities or proportionate regular pension contributions). Both monetary and non-monetary benefits should be included.
- (65) In any event, in order to avoid excessive risk taking, a maximum ratio between the fixed and the variable component of the total remuneration should be set. It is appropriate to provide for a certain role for the shareholders, owners or members of institutions in that respect. Member States should be able to set stricter requirements as regards the relationship between the fixed and the variable components of the total remuneration. With a view to encouraging the use of equity or debt instruments which are payable under long-term deferral arrangements as a component of variable remuneration, Member States should be able, within certain limits, to allow institutions to apply a notional discount rate when calculating the value of such instruments for the purposes of applying the maximum ratio. However, Member States should not be obliged to provide for such a facility and should be able to provide for it to apply to a lower maximum percentage of total variable remuneration than set out in this Directive. With a view to ensuring a harmonised and coherent approach which guarantees a level playing field across the internal market, EBA should provide appropriate guidance on the applicable notional discount rate to be used.
- (66) In order to ensure that the design of remuneration policies is integrated in the risk management of the institution, the management body should adopt and periodically review the remuneration policies in place. The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles.
- (67) In order to protect and foster financial stability within the Union and to address any possible avoidance of the requirements laid down in this Directive, competent authorities should ensure compliance with the principles and rules on remuneration for institutions on a consolidated basis, that is at the level of the group, parent undertakings and subsidiaries, including the branches and subsidiaries established in third countries.
- (68) Since poorly designed remuneration policies and incentive schemes are capable of increasing to an unacceptable extent the risks to which credit institutions and investment firms are exposed, prompt remedial action and, if necessary, appropriate corrective measures should be taken. Consequently, it is appropriate to ensure that competent authorities have the power to impose qualitative or quantitative measures on the relevant institutions that are designed to address problems that have been identified in relation to remuneration policies in the supervisory review.
- (69) The provisions on remuneration should be without prejudice to the full exercise of fundamental rights guaranteed by Article 153(5) TFEU, general principles of national contract and labour law, Union and national law regarding shareholders' rights and involvement and the general responsibilities of the management bodies of the institution concerned, and the rights, where applicable, of the social partners to conclude and enforce collective agreements, in accordance with national law and customs.



- (70) Own funds requirements for credit risk and market risk should be based on external credit ratings only to the extent necessary. Where credit risk is material, institutions should therefore generally seek to implement internal ratings-based approaches or internal models. However, standardised approaches that rely on external credit ratings could be used where credit risk is less material, which is typically the case for less sophisticated institutions, for insignificant exposure classes, or in situations where using internal approaches would be overly burdensome.
- (71) Directives 2006/48/EC and 2006/49/EC are one of the pillars upon which the overreliance on external credit ratings was built. This Directive should take into account the G-20 conclusions and the FSB principles for Reducing Reliance on external credit ratings. Institutions should therefore be encouraged to use internal ratings rather than external credit ratings even for the purpose of calculating own funds requirements.
- (72) Overreliance on external credit ratings should be reduced and the automatic effects deriving from them should be gradually eliminated. Institutions should therefore be required to put in place sound credit-granting criteria and credit decision-making processes. Institutions should be able to use external credit ratings as one of several factors in that process but they should not rely solely or mechanistically on them.
- (73) The recognition of a credit rating agency as an external credit assessment institution (ECAI) should not increase the foreclosure of a market already dominated by three undertakings. EBA, the Member States' central banks and the ECB, without making the process easier or less demanding, should provide for the recognition of more credit rating agencies as ECAs in order to open the market to other undertakings.
- (74) Given the wide range of approaches adopted by institutions using internal modelling approaches, it is important that competent authorities and EBA have a clear view of the range of values for risk-weighted assets and own funds requirements that arise for similar exposures under such approaches. To that end, institutions should be required to provide competent authorities with the results of internal models applied to EBA-developed benchmark portfolios covering a wide range of exposures. Based on the information received, competent authorities should take appropriate steps to ensure that similarities or differences in results for the same exposure are justifiable in terms of the risks incurred. More generally, the competent authorities and EBA should ensure that the choice between an internal modelling approach and a standardised approach does not result in the under-estimation of own funds requirements. While own funds requirements for operational risk are more difficult to allocate at individual exposure level and it is therefore appropriate to exclude this risk category from the benchmarking process, competent authorities should nevertheless keep abreast of developments in internal modelling approaches to operational risk, with the aim of monitoring the range of practices employed and improving supervisory approaches.
- (75) The development of relationship-based lending should be encouraged where information gleaned from a continuing business relationship with clients is used to get a better quality of due diligence and risk assessment than is available purely from standardised information and credit scores.
- (76) With respect to the supervision of liquidity, responsibility should lie with home Member States as soon as detailed criteria for the liquidity coverage requirement apply. It is therefore necessary to accomplish the coordination of supervision in this field in order to introduce supervision by the home Member State by that time. In order to ensure effective supervision, the competent authorities of the home and host Member States should further cooperate in the field of liquidity.
- (77) Where within a group liquid assets in one institution will under stress circumstances match liquidity needs of another member of that group, competent authorities should be able to exempt an institution from liquidity coverage requirements and apply those requirements on a consolidated basis instead.
- (78) Measures taken on the basis of this Directive should be without prejudice to measures taken in accordance with Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions<sup>(1)</sup>. Supervisory measures should not lead to discrimination among creditors from different Member States.
- (79) In the light of the financial crisis and the pro-cyclical mechanisms that contributed to its origin and aggravated its effect, the FSB, the Basel Committee on Banking Supervision (BCBS), and the G-20 made recommendations to mitigate the pro-cyclical effects of financial regulation. In December 2010, the BCBS issued new global regulatory standards on bank capital adequacy (the Basel III rules), including rules requiring the maintenance of capital conservation and countercyclical capital buffers.

<sup>(1)</sup> OJ L 125, 5.5.2001, p. 15.



- (80) It is therefore appropriate to require credit institutions and relevant investment firms to hold, in addition to other own fund requirements, a capital conservation buffer and a countercyclical capital buffer to ensure that they accumulate, during periods of economic growth, a sufficient capital base to absorb losses in stressed periods. The countercyclical capital buffer should be built up when aggregate growth in credit and other asset classes with a significant impact on the risk profile of such credit institutions and investment firms are judged to be associated with a build-up of system-wide risk, and drawn down during stressed periods.
- (81) In order to ensure that countercyclical capital buffers properly reflect the risk to the banking sector of excessive credit growth, credit institutions and investment firms should calculate their institution-specific buffers as a weighted average of the countercyclical buffer rates that apply in the countries where their credit exposures are located. Every Member State should therefore designate an authority responsible for the quarterly setting of the countercyclical buffer rate for exposures located in that Member State. That buffer rate should take into account the growth of credit levels and changes to the ratio of credit to GDP in that Member State, and any other variables relevant to the risks to the stability of the financial system.
- (82) In order to promote international consistency in setting countercyclical buffer rates, the BCBS has developed a methodology on the basis of the ratio between credit and GDP. This should serve as a common starting point for decisions on buffer rates by the relevant national authorities, but should not give rise to an automatic buffer setting or bind the designated authority. The buffer rate should reflect, in a meaningful way, the credit cycle and the risks due to excess credit growth in the Member State and should duly take into account specificities of the national economy.
- (83) Restrictions on variable remuneration are an important element in ensuring that credit institutions and investment firms rebuild their capital levels when operating within the buffer range. Credit institutions and investment firms are already subject to the principle that awards and discretionary payments of variable remuneration to those categories of staff whose professional activities have a material impact on the risk profile of the institution have to be sustainable, having regard to the financial situation of the institution. In order to ensure that an institution restores its levels of own funds in a timely manner, it is appropriate to align the award of variable remuneration and discretionary pension benefits with the profit situation of the institution during any period in which the combined buffer requirement is not met, taking into account the long-term health of the institution.
- (84) Institutions should address and control all concentration risks by means of written policies and procedures. Given the nature of public sector exposures, controlling concentration risks is more effective than risk weighting those exposures, given their size and the difficulties in calibrating own funds requirements. The Commission should, at an appropriate time, submit a report to the European Parliament and the Council about any desirable changes to the prudential treatment of concentration risk.
- (85) Member States should be able to require certain institutions to hold, in addition to a capital conservation buffer and a countercyclical capital buffer, a systemic risk buffer in order to prevent and mitigate long-term non-cyclical systemic or macroprudential risks not covered by Regulation (EU) No 575/2013, where there is a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy in a specific Member State. The systemic risk buffer rate should apply to all institutions, or to one or more subsets of those institutions, where the institutions exhibit similar risk profiles in their business activities.
- (86) In order to ensure consistent macroprudential oversight across the Union, it is appropriate that the European Systemic Risk Board (ESRB) develop principles tailored to the Union economy and be responsible for monitoring their application. This Directive should not prevent the ESRB from taking any actions that it considers necessary under Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macroprudential oversight of the financial system and establishing a European Systemic Risk Board <sup>(1)</sup>.
- (87) Member States should be able to recognise the systemic risk buffer rate set by another Member State and apply that buffer rate to domestically authorised institutions for the exposures located in the Member State setting the buffer rate. The Member State setting the buffer rate should also be able to ask the ESRB to issue a recommendation as referred to in Article 16 of Regulation (EU) No 1092/2010, addressed to one or more Member States which are in a position to recognise the systemic risk buffer rate recommending that they do so. Such a recommendation is subject to the "comply or explain" rule set out in Article 3(2) and Article 17 of that Regulation.
- (88) It is appropriate that decisions of Member States on countercyclical buffer rates are coordinated as far as possible. In that regard, the ESRB, if requested to do so by competent or designated authorities, could facilitate discussions between those authorities about setting proposed buffer rates, including relevant variables.

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

- (89) Where a credit institution or investment firm fails to meet in full the combined buffer requirement, it should be subject to measures designed to ensure that it restores its levels of own funds in a timely manner. In order to conserve capital, it is appropriate to impose proportionate restrictions on discretionary distributions of profits, including dividend payments and payments of variable remuneration. So as to ensure that such institutions or firms have a credible strategy to restore levels of own funds, they should be required to draw up and agree with the competent authorities a capital conservation plan that sets out how the restrictions on distributions will be applied and other measures that the institution or firm intends to take to ensure compliance with the full buffer requirements.
- (90) Authorities are expected to impose higher own funds requirements on global systemically important institutions (G-SIIs) in order to compensate for the higher risk that G-SIIs represent for the financial system and the potential impact of their failure on taxpayers. Where an authority imposes the systemic risk buffer and the G-SII buffer is applicable, the higher of the two should apply. Where the systemic risk buffer only applies to domestic exposures, it should be cumulative with the G-SII buffer or the buffer relating to other systemically important institutions (O-SIIs) which is applied in accordance with this Directive.
- (91) Technical standards in financial services should ensure consistent harmonisation 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. EBA should ensure efficient administrative and reporting processes when drafting technical standards.
- (92) The Commission should adopt regulatory technical standards developed by EBA in the areas of authorisations and acquisitions of significant holdings in credit institutions, information exchanges between competent authorities, the exercise of the freedom of establishment and the freedom to provide services, supervisory collaboration, remuneration policies of credit institutions and investment firms and the supervision of mixed financial holding companies by means of delegated acts pursuant to Article 290 TFEU and in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010. The Commission and EBA should ensure that those standards can be applied by all institutions concerned in a manner that is proportionate to the nature, scale and complexity of those institutions and their activities.
- (93) Given the detail and number of regulatory technical standards that are to be adopted pursuant to this Directive, where the Commission adopts a regulatory technical standard which is the same as the draft regulatory technical standard submitted by EBA, the period within which the European Parliament or the Council may object to a regulatory technical standard should, where appropriate, be further extended by one month. Moreover, the Commission should aim to adopt the regulatory technical standards in good time to permit the European Parliament and the Council to exercise full scrutiny, taking account of the volume and complexity of regulatory technical standards and the details of the European Parliament's and the Council's rules of procedure, calendar of work and composition.
- (94) The Commission should also be empowered to adopt implementing technical standards developed by EBA in the areas of authorisation of and acquisitions of significant holdings in credit institutions, information exchange between competent authorities, supervisory collaboration, specific prudential requirements and disclosure of information by supervisory authorities by means of implementing acts pursuant to Article 291 TFEU and in accordance with Article 15 of Regulation (EU) No 1093/2010.
- (95) In order to ensure uniform conditions for the implementation of this Directive, 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 of 16 February 2011 on laying down the rules and general principles concerning mechanisms for control by the Member States of the Commission's exercise of implementing powers<sup>(1)</sup>.
- (96) In order to specify the requirements set out in this Directive, the power to adopt acts in accordance with Article 290 TFEU should be delegated to the Commission in respect of clarifying the definitions and the terminology used in this Directive, expanding the list of activities subject to mutual recognition and improving the exchange of information concerning branches of credit institutions. 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 to the Council.
- (97) References to Directives 2006/48/EC and 2006/49/EC should be construed as references to this Directive and to Regulation (EU) No 575/2013.

<sup>(1)</sup> OJ L 55, 28.2.2011, p. 13.

- (98) Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate <sup>(1)</sup>, Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market <sup>(2)</sup>, 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>(3)</sup>, Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions <sup>(4)</sup> and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers <sup>(5)</sup> refer to provisions of Directives 2006/48/EC and 2006/49/EC concerning own funds requirements which should be set out in this Directive and in Regulation (EU) No 575/2013. Consequently, references in those Directives to Directives 2006/48/EC and 2006/49/EC should be construed as references to the provisions governing own funds requirements in this Directive and in Regulation (EU) No 575/2013.
- (99) In order to allow for technical standards to be developed so that institutions that are part of a financial conglomerate apply the appropriate calculation methods for the determination of required capital on a consolidated basis, Directive 2002/87/EC should be amended accordingly.
- (100) In order for the internal banking market to operate with increasing effectiveness and for citizens of the Union to be afforded adequate levels of transparency, it is necessary that competent authorities publish, in a manner which allows for meaningful comparison, information on the manner in which this Directive is implemented.
- (101) With respect to the supervision of liquidity, there should be a period of time within which Member States effect transition towards the regulatory regime under which detailed criteria for the liquidity coverage requirement apply.
- (102) In order to ensure a stable, smooth and progressive transition by institutions to new liquidity and stable funding requirements at Union level, competent authorities should make full use of their supervisory powers under this Directive and under any applicable national law. In particular, competent authorities should assess whether there is a need to apply administrative penalties or other administrative measures, including prudential charges, the level of which should broadly relate to the disparity between the actual liquidity position of an institution and the liquidity and stable funding requirements. In making this assessment, competent authorities should have due regard to market conditions. Such administrative penalties or other administrative measures should apply until detailed legal acts on liquidity and stable funding requirements are implemented at Union level.
- (103) Directive 95/46/EC 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>(6)</sup> and Regulation (EC) 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 Community institutions and bodies and on the free movement of such data <sup>(7)</sup>, should be fully applicable to the processing of personal data for the purposes of this Directive.
- (104) Since the objectives of this Directive, namely the introduction of rules concerning access to the activity of institutions, and the prudential supervision of institutions, cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and the effects of the proposed action, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve those objectives.
- (105) In accordance with the Joint Political Declaration of Member States and the Commission on explanatory documents of 28 September 2011, Member States have undertaken to accompany, in justified cases, the notification of their transposition measures with one or more documents explaining the relationship between the components of a directive and the corresponding parts of national transposition instruments. With regard to this Directive, the legislator considers the transmission of such documents to be justified.
- (106) The European Data Protection Supervisor has been consulted in accordance with Article 28(2) of Regulation (EC) No 45/2001 and has adopted an opinion <sup>(8)</sup>.

<sup>(1)</sup> OJ L 35, 11.2.2003, p. 1.

<sup>(2)</sup> OJ L 319, 5.12.2007, p. 1.

<sup>(3)</sup> OJ L 302, 17.11.2009, p. 32.

<sup>(4)</sup> OJ L 267, 10.10.2009, p. 7.

<sup>(5)</sup> OJ L 174, 1.7.2011, p. 1.

<sup>(6)</sup> OJ L 281, 23.11.1995, p. 31.

<sup>(7)</sup> OJ L 8, 12.1.2001, p. 1.

<sup>(8)</sup> OJ C 175, 19.6.2012, p. 1.

(107) Directive 2002/87/EC should be amended accordingly and Directives 2006/48/EC and 2006/49/EC should be repealed,

HAVE ADOPTED THIS DIRECTIVE:

#### TITLE I

### SUBJECT MATTER, SCOPE AND DEFINITIONS

#### Article 1

#### Subject matter

This Directive lays down rules concerning:

- (a) access to the activity of credit institutions and investment firms (collectively referred to as "institutions");
- (b) supervisory powers and tools for the prudential supervision of institutions by competent authorities;
- (c) the prudential supervision of institutions by competent authorities in a manner that is consistent with the rules set out in Regulation (EU) No 575/2013;
- (d) publication requirements for competent authorities in the field of prudential regulation and supervision of institutions.

#### Article 2

#### Scope

1. This Directive shall apply to institutions.
2. Article 30 shall apply to local firms.
3. Article 31 shall apply to the firms referred to in point (2)(c) of Article 4(1) of Regulation (EU) No 575/2013.
4. Article 34 and Title VII, Chapter 3 shall apply to financial holding companies, mixed financial holding companies and mixed-activity holding companies which have their head offices in the Union;
5. This Directive shall not apply to the following:
  - (1) access to the activity of investment firms in so far as it is regulated by Directive 2004/39/EC;
  - (2) central banks;
  - (3) post office giro institutions;

(4) in Belgium, the 'Institut de Réescmpte et de Garantie/Herdisconterings- en Waarborginstituut';

(5) in Denmark, the 'Eksport Kredit Fonden', the 'Eksport Kredit Fonden A/S', the 'Danmarks Skibskredit A/S' and the 'KommuneKredit';

(6) in Germany, the 'Kreditanstalt für Wiederaufbau', undertakings which are recognised under the 'Wohnungsgemeinnützigkeitsgesetz' as bodies of State housing policy and are not mainly engaged in banking transactions, and undertakings recognised under that law as non-profit housing undertakings;

(7) in Estonia, the 'hoiu-laenuühistus', as cooperative undertakings that are recognised under the 'hoiu-laenuühistuseadus';

(8) in Ireland, credit unions and the friendly societies;

(9) in Greece, the 'Ταμείο Παρακαταθηκών και Δανείων' (Tamio Parakatathikon kai Danion);

(10) in Spain, the 'Instituto de Crédito Oficial';

(11) in France, the 'Caisse des dépôts et consignations';

(12) in Italy, the 'Cassa depositi e prestiti';

(13) in Latvia, the 'krājaizdevu sabiedrības', undertakings that are recognised under the 'krājaizdevu sabiedrību likums' as cooperative undertakings rendering financial services solely to their members;

(14) in Lithuania, the 'kredito unijos' other than the 'Centrinė kredito unija';

(15) in Hungary, the 'MFB Magyar Fejlesztési Bank Zártkörűen Működő Részvénytársaság' and the 'Magyar Export-Import Bank Zártkörűen Működő Részvénytársaság';

(16) in the Netherlands, the 'Nederlandse Investeringsbank voor Ontwikkelingslanden NV', the 'NV Noordelijke Ontwikkelingsmaatschappij', the 'NV Industriebank Limburgs Instituut voor Ontwikkeling en Financiering' and the 'Overijsselse Ontwikkelingsmaatschappij NV';

(17) in Austria, undertakings recognised as housing associations in the public interest and the 'Österreichische Kontrollbank AG';



- (18) in Poland, the 'Spółdzielcze Kasy Oszczędnościowo — Kredytowe' and the 'Bank Gospodarstwa Krajowego';
- (19) in Portugal, the 'Caixas Económicas' existing on 1 January 1986 with the exception of those incorporated as limited companies and of the 'Caixa Económica Montepio Geral';
- (20) in Slovenia, the 'SID-Slovenska izvozna in razvojna banka, d.d. Ljubljana';
- (21) in Finland, the 'Teollisen yhteistyön rahasto Oy/Fonden för industriellt samarbete AB', and the 'Finnvera Oyj/Finnvera Abp';
- (22) in Sweden, the 'Svenska Skeppshypotekskassan';
- (23) in the United Kingdom, the National Savings Bank, the Commonwealth Development Finance Company Ltd, the Agricultural Mortgage Corporation Ltd, the Scottish Agricultural Securities Corporation Ltd, the Crown Agents for overseas governments and administrations, credit unions and municipal banks.
6. The entities referred to in point (1) and points (3) to (23) of paragraph 5 of this Article shall be treated as financial institutions for the purposes of Article 34 and Title VII, Chapter 3.

### Article 3

#### Definitions

1. For the purposes of this Directive, the following definitions shall apply:

- (1) 'credit institution' means credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013;
- (2) 'investment firm' means investment firm as defined in point (2) of Article 4(1) of Regulation (EU) No 575/2013;
- (3) 'institution' means institution as defined in point (3) of Article 4(1) of Regulation (EU) No 575/2013;
- (4) 'local firm' means local firm as defined in point (4) of Article 4(1) of Regulation (EU) No 575/2013;
- (5) 'insurance undertaking' means insurance undertaking as defined in point (5) of Article 4(1) of Regulation (EU) No 575/2013;
- (6) 'reinsurance undertaking' means reinsurance undertaking as defined in point (6) of Article 4(1) of Regulation (EU) No 575/2013;
- (7) 'management body' means an institution's body or bodies, which are appointed in accordance with national law, which are empowered to set the institution's strategy, objectives and overall direction, and which oversee and monitor management decision-making, and include the persons who effectively direct the business of the institution;
- (8) 'management body in its supervisory function' means the management body acting in its role of overseeing and monitoring management decision-making;
- (9) 'senior management' means those natural persons who exercise executive functions within an institution and who are responsible, and accountable to the management body, for the day-to-day management of the institution;
- (10) 'systemic risk' means a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy;
- (11) 'model risk' means the potential loss an institution may incur, as a consequence of decisions that could be principally based on the output of internal models, due to errors in the development, implementation or use of such models;
- (12) 'originator' means originator as defined in point (13) of Article 4(1) of Regulation (EU) No 575/2013;
- (13) 'sponsor' means sponsor as defined in point (14) of Article 4(1) of Regulation (EU) No 575/2013;
- (14) 'parent undertaking' means parent undertaking as defined in point (15) of Article 4(1) of Regulation (EU) No 575/2013;
- (15) 'subsidiary' means subsidiary as defined in point (16) of Article 4(1) of Regulation (EU) No 575/2013;
- (16) 'branch' means branch as defined in point (17) of Article 4(1) of Regulation (EU) No 575/2013;
- (17) 'ancillary services undertaking' means ancillary services undertaking as defined in point (18) of Article 4(1) of Regulation (EU) No 575/2013;
- (18) 'asset management company' means asset management company as defined in point (19) of Article 4(1) of Regulation (EU) No 575/2013;



- (19) 'financial holding company' means financial holding company as defined in point (20) of Article 4(1) of Regulation (EU) No 575/2013;
- (20) 'mixed financial holding company' means mixed financial holding company as defined in point (21) of Article 4(1) of Regulation (EU) No 575/2013;
- (21) 'mixed activity holding company' means mixed activity holding company as defined in point (22) of Article 4(1) of Regulation (EU) No 575/2013;
- (22) 'financial institution' means financial institution as defined in point (26) of Article 4(1) of Regulation (EU) No 575/2013;
- (23) 'financial sector entity' means financial sector entity as defined in point (27) of Article 4(1) of Regulation (EU) No 575/2013;
- (24) 'parent institution in a Member State' means parent institution in a Member State as defined in point (28) of Article 4(1) of Regulation (EU) No 575/2013;
- (25) 'EU parent institution' means EU parent institution as defined in point (29) of Article 4(1) of Regulation (EU) No 575/2013;
- (26) 'parent financial holding company in a Member State' means parent financial holding company in a Member State as defined in point (30) of Article 4(1) of Regulation (EU) No 575/2013;
- (27) 'EU parent financial holding company' means EU parent financial holding company as defined in point (31) of Article 4(1) of Regulation (EU) No 575/2013;
- (28) 'parent mixed financial holding company in a Member State' means parent mixed financial holding company in a Member State as defined in point (32) of Article 4(1) of Regulation (EU) No 575/2013;
- (29) 'EU parent mixed financial holding company' means EU parent mixed financial holding company as defined in point (33) of Article 4(1) of Regulation (EU) No 575/2013;
- (30) 'systemically important institution' means an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or an institution the failure or malfunction of which could lead to systemic risk;
- (31) 'central counterparty' means central counterparty as defined in point (34) of Article 4(1) of Regulation (EU) No 575/2013;
- (32) 'participation' means participation as defined in point (35) of Article 4(1) of Regulation (EU) No 575/2013;
- (33) 'qualifying holding' means qualifying holding as defined in point (36) of Article 4(1) of Regulation (EU) No 575/2013;
- (34) 'control' means control as defined in point (37) of Article 4(1) of Regulation (EU) No 575/2013;
- (35) 'close links' means close links as defined in point (38) of Article 4(1) of Regulation (EU) No 575/2013;
- (36) 'competent authority' means competent authority as defined in point (40) of Article 4(1) of Regulation (EU) No 575/2013;
- (37) 'consolidating supervisor' means consolidating supervisor as defined in point (41) of Article 4(1) of Regulation (EU) No 575/2013;
- (38) 'authorisation' means authorisation as defined in point (42) of Article 4(1) of Regulation (EU) No 575/2013;
- (39) 'home Member State' means home Member State as defined in point (43) of Article 4(1) of Regulation (EU) No 575/2013;
- (40) 'host Member State' means host Member State as defined in point (44) of Article 4(1) of Regulation (EU) No 575/2013;
- (41) 'ESCB central banks' means ESCB central banks as defined in point (45) of Article 4(1) of Regulation (EU) No 575/2013;
- (42) 'central banks' means central banks as defined in point (46) of Article 4(1) of Regulation (EU) No 575/2013;
- (43) 'consolidated situation' means consolidated situation as defined in point (47) of Article 4(1) of Regulation (EU) No 575/2013;
- (44) 'consolidated basis' means consolidated basis as defined in point (48) of Article 4(1) of Regulation (EU) No 575/2013;
- (45) 'sub-consolidated basis' means sub-consolidated basis as defined in point (49) of Article 4(1) of Regulation (EU) No 575/2013;

- (46) 'financial instrument' means financial instrument as defined in point (50) of Article 4(1) of Regulation (EU) No 575/2013;
- (47) 'own funds' means own funds as defined in point (118) of Article 4(1) of Regulation (EU) No 575/2013;
- (48) 'operational risk' means operational risk as defined in point (52) of Article 4(1) of Regulation (EU) No 575/2013;
- (49) 'credit risk mitigation' means credit risk mitigation as defined in point (57) of Article 4(1) of Regulation (EU) No 575/2013;
- (50) 'securitisation' means securitisation as defined in point (61) of Article 4(1) of Regulation (EU) No 575/2013;
- (51) 'securitisation position' means securitisation position as defined in point (62) of Article 4(1) of Regulation (EU) No 575/2013;
- (52) 'securitisation special purpose entity' means securitisation special purpose entity as defined in point (66) of Article 4(1) of Regulation (EU) No 575/2013;
- (53) 'discretionary pension benefits' means discretionary pension benefits as defined in point (73) of Article 4(1) of Regulation (EU) No 575/2013;
- (54) 'trading book' means trading as defined in point (86) of Article 4(1) of Regulation (EU) No 575/2013;
- (55) 'regulated market' means regulated market as defined in point (92) of Article 4(1) of Regulation (EU) No 575/2013;
- (56) 'leverage' means leverage as defined in point (93) of Article 4(1) of Regulation (EU) No 575/2013;
- (57) 'risk of excessive leverage' means risk of excessive leverage as defined in point (94) of Article 4(1) of Regulation (EU) No 575/2013;
- (58) 'external credit assessment institution' means external credit assessment institution as defined in point (98) of Article 4(1) of Regulation (EU) No 575/2013;
- (59) 'internal approaches' means the internal ratings based approach referred to in Article 143(1), the internal models approach referred to in Article 221, the own

estimates approach referred to in Article 225, the advanced measurement approaches referred to in Article 312(2), the internal models method referred to in Articles 283 and 363, and the internal assessment approach referred to in Article 259(3) of Regulation (EU) No 575/2013.

2. Where this Directive refers to the management body and, pursuant to national law, the managerial and supervisory functions of the management body are assigned to different bodies or different members within one body, the Member State shall identify the bodies or members of the management body responsible in accordance with its national law, unless otherwise specified by this Directive.

## TITLE II

### COMPETENT AUTHORITIES

#### Article 4

##### Designation and powers of the competent authorities

1. Member States shall designate competent authorities that carry out the functions and duties provided for in this Directive and in Regulation (EU) No 575/2013. They shall inform the Commission and EBA thereof, indicating any division of functions and duties.

2. Member States shall ensure that the competent authorities monitor the activities of institutions, and where applicable, of financial holding companies and mixed financial holding companies, so as to assess compliance with the requirements of this Directive and Regulation (EU) No 575/2013.

3. Member States shall ensure that appropriate measures are in place to enable the competent authorities to obtain the information needed to assess the compliance of institutions and, where applicable, of financial holding companies and mixed financial holding companies, with the requirements referred to in paragraph 2 and to investigate possible breaches of those requirements.

4. Member States shall ensure that the competent authorities have the expertise, resources, operational capacity, powers and independence necessary to carry out the functions relating to prudential supervision, investigations and penalties set out in this Directive and in Regulation (EU) No 575/2013.

5. Member States shall require that institutions provide the competent authorities of their home Member States with all the information necessary for the assessment of their compliance with the rules adopted in accordance with this Directive and Regulation (EU) No 575/2013. Member States shall also ensure that internal control mechanisms and administrative and accounting procedures of the institutions permit the checking of their compliance with such rules at all times.

6. Member States shall ensure that institutions register all their transactions and document systems and processes, which are subject to this Directive and Regulation (EU) No 575/2013 in such a manner that the competent authorities are able to check compliance with this Directive and Regulation (EU) No 575/2013 at all times.

7. Member States shall ensure that the functions of supervision pursuant to this Directive and to Regulation (EU) No 575/2013 and any other functions of the competent authorities are separate and independent from the functions relating to resolution. Member States shall inform the Commission and EBA thereof, indicating any division of duties.

8. Member States shall ensure that where authorities other than the competent authorities have the power of resolution, those other authorities cooperate closely and consult the competent authorities with regard to the preparation of resolution plans.

#### Article 5

##### Coordination within Member States

Where Member States have more than one competent authority for the prudential supervision of credit institutions, investment firms and financial institutions, Member States shall take the requisite measures to organise coordination between such authorities.

#### Article 6

##### Cooperation within the European System of Financial Supervision

In the exercise of their duties, the competent authorities shall take into account the convergence in respect of supervisory tools and supervisory practices in the application of the laws, regulations and administrative requirements adopted pursuant to this Directive and to Regulation (EU) No 575/2013. For that purpose, Member States shall ensure that:

- (a) the competent authorities, as parties to the European System of Financial Supervision (ESFS), cooperate with trust and full mutual respect, in particular when ensuring the flow of appropriate and reliable information between them and other parties to the ESFS, in accordance with the principle of sincere cooperation set out in Article 4(3) of the Treaty on European Union;
- (b) the competent authorities participate in the activities of EBA and, as appropriate, in the colleges of supervisors;
- (c) the competent authorities make every effort to comply with those guidelines and recommendations issued by EBA in accordance with Article 16 of Regulation (EU)

No 1093/2010 and to respond to the warnings and recommendations issued by the ESRB pursuant to Article 16 of Regulation (EU) No 1092/2010;

- (d) the competent authorities cooperate closely with the ESRB;
- (e) national mandates conferred on the competent authorities do not inhibit the performance of their duties as members of EBA, of the ESRB, where appropriate, or under this Directive and under Regulation (EU) No 575/2013.

#### Article 7

##### Union dimension of supervision

The competent authorities in each Member State shall, in the exercise of their general duties, duly consider the potential impact of their decisions on the stability of the financial system in the other Member States concerned and, in particular, in emergency situations, based on the information available at the relevant time.

#### TITLE III

##### REQUIREMENTS FOR ACCESS TO THE ACTIVITY OF CREDIT INSTITUTIONS

###### CHAPTER 1

##### General requirements for access to the activity of credit institutions

#### Article 8

##### Authorisation

1. Member States shall require credit institutions to obtain authorisation before commencing their activities. Without prejudice to Articles 10 to 14, they shall lay down the requirements for such authorisation and notify EBA.
2. EBA shall develop draft regulatory technical standards to specify:
  - (a) the information to be provided to the competent authorities in the application for the authorisation of credit institutions, including the programme of operations provided for in Article 10;
  - (b) the requirements applicable to shareholders and members with qualifying holdings pursuant to Article 14; and
  - (c) obstacles which may prevent effective exercise of the supervisory functions of the competent authority, as referred to in Article 14.

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

3. EBA shall develop draft implementing technical standards on standard forms, templates and procedures for the provision of the information referred to in point (a) of the first subparagraph of paragraph 2.

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

4. EBA shall submit the draft technical standards referred to in paragraphs 2 and 3 to the Commission by 31 December 2015.

#### Article 9

### **Prohibition against persons or undertakings other than credit institutions from carrying out the business of taking deposits or other repayable funds from the public**

1. Member States shall prohibit persons or undertakings that are not credit institutions from carrying out the business of taking deposits or other repayable funds from the public.

2. Paragraph 1 shall not apply to the taking of deposits or other funds repayable by a Member State, or by a Member State's regional or local authorities, by public international bodies of which one or more Member States are members, or to cases expressly covered by national or Union law, provided that those activities are subject to regulations and controls intended to protect depositors and investors.

#### Article 10

### **Programme of operations and structural organisation**

Member States shall require applications for authorisation to be accompanied by a programme of operations setting out the types of business envisaged and the structural organisation of the credit institution.

#### Article 11

### **Economic needs**

Member States shall not require the application for authorisation to be examined in terms of the economic needs of the market.

#### Article 12

### **Initial capital**

1. Without prejudice to other general conditions laid down in national law, the competent authorities shall refuse authorisation to commence the activity of a credit institution where a credit institution does not hold separate own funds or where its initial capital is less than EUR 5 million.

2. Initial capital shall comprise only one or more of the items referred to in Article 26(1)(a) to (e) of Regulation (EU) No 575/2013.

3. Member States may decide that credit institutions which do not fulfil the requirement to hold separate own funds and which were in existence on 15 December 1979 may continue to carry out their business. They may exempt such credit institutions from complying with the requirement contained in the first subparagraph of Article 13(1).

4. Member States may grant authorisation to particular categories of credit institutions the initial capital of which is less than that specified in paragraph 1, subject to the following conditions:

(a) the initial capital is no less than EUR 1 million;

(b) the Member States concerned notify the Commission and EBA of their reasons for exercising that option.

#### Article 13

### **Effective direction of the business and place of the head office**

1. The competent authorities shall grant authorisation to commence the activity of a credit institution only where at least two persons effectively direct the business of the applicant credit institution.

They shall refuse such authorisation if the members of the management body do not meet the requirements referred to in Article 91(1).

2. Each Member State shall require that:

(a) a credit institution which is a legal person and which, under its national law, has a registered office, has its head office in the same Member State as its registered office;

(b) a credit institution other than that referred to in point (a) has its head office in the Member State which granted it authorisation and in which it actually carries out its business.

#### Article 14

### **Shareholders and members**

1. The competent authorities shall refuse authorisation to commence the activity of a credit institution unless a credit institution has informed them of the identities of its shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings and of the amounts of those holdings or, where there are no qualifying holdings, of the 20 largest shareholders or members.

In determining whether the criteria for a qualifying holding are fulfilled, the voting rights referred to in Articles 9 and 10 of Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market <sup>(1)</sup> and the conditions regarding aggregation thereof set out in Article 12(4) and (5) of that Directive, shall be taken into account.

Member States shall not take into account voting rights or shares which institutions hold as a result of providing the underwriting of financial instruments or placing of financial instruments on a firm commitment basis included under point 6 of Section A of Annex I to Directive 2004/39/EC, provided that those rights are not exercised or otherwise used to intervene in the management of the issuer and are disposed of within one year of acquisition.

2. The competent authorities shall refuse authorisation to commence the activity of a credit institution if, taking into account the need to ensure the sound and prudent management of a credit institution, they are not satisfied as to the suitability of the shareholders or members, in particular where the criteria set out in Article 23(1) are not met. Article 23(2) and (3) and Article 24 shall apply.

3. Where close links exist between the credit institution and other natural or legal persons, competent authorities shall grant authorisation only if those links do not prevent the effective exercise of their supervisory functions.

The competent authorities shall refuse authorisation to commence the activity of a credit institution where the laws, regulations or administrative provisions of a third country governing one or more natural or legal persons with which the credit institution has close links, or difficulties involved in the enforcement of those laws, regulations or administrative provisions, prevent the effective exercise of their supervisory functions.

The competent authorities shall require credit institutions to provide them with the information they require to monitor compliance with the conditions referred to in this paragraph on an ongoing basis.

#### Article 15

##### Refusal of authorisation

Where a competent authority refuses authorisation to commence the activity of a credit institution, it shall notify the applicant of the decision and the reasons therefor within

six months of receipt of the application or, where the application is incomplete, within six months of receipt of the complete information required for the decision.

A decision to grant or refuse authorisation shall, in any event, be taken within 12 months of the receipt of the application.

#### Article 16

##### Prior consultation of the competent authorities of other Member States

1. The competent authority shall, before granting authorisation to a credit institution, consult the competent authorities of another Member State where the credit institution is:

- (a) a subsidiary of a credit institution authorised in that other Member State;
- (b) a subsidiary of the parent undertaking of a credit institution authorised in that other Member State;
- (c) controlled by the same natural or legal persons as those who control a credit institution authorised in that other Member State.

2. The competent authority shall, before granting authorisation to a credit institution, consult the competent authority that is responsible for the supervision of insurance undertakings or investment firms in the Member State concerned where the credit institution is:

- (a) a subsidiary of an insurance undertaking or investment firm authorised in the Union;
- (b) a subsidiary of the parent undertaking of an insurance undertaking or investment firm authorised in the Union;
- (c) controlled by the same natural or legal persons as those who control an insurance undertaking or investment firm authorised in the Union.

3. The relevant competent authorities referred to in paragraphs 1 and 2 shall in particular consult each other when assessing the suitability of the shareholders and the reputation and experience of members of the management body involved in the management of another entity of the same group. They shall exchange any information regarding the suitability of shareholders and the reputation and experience of members of the management body which is of relevance for the granting of an authorisation and for the ongoing assessment of compliance with operating conditions.

<sup>(1)</sup> OJ L 390, 31.12.2004, p. 38.



*Article 17***Branches of credit institutions authorised in another Member State**

Host Member States shall not require authorisation or endowment capital for branches of credit institutions authorised in other Member States. The establishment and supervision of such branches shall be effected in accordance with Article 35, Article 36(1), (2) and (3), Article 37, Articles 40 to 46, Article 49 and Articles 74 and 75.

*Article 18***Withdrawal of authorisation**

The competent authorities may only withdraw the authorisation granted to a credit institution where such a credit institution:

- (a) does not make use of the authorisation within 12 months, expressly renounces the authorisation or has ceased to engage in business for more than six months, unless the Member State concerned has made provision for the authorisation to lapse in such cases;
- (b) has obtained the authorisation through false statements or any other irregular means;
- (c) no longer fulfils the conditions under which authorisation was granted;
- (d) no longer meets the prudential requirements set out in Parts Three, Four or Six of Regulation (EU) No 575/2013 or imposed under Article 104(1)(a) or Article 105 of this Directive or can no longer be relied on to fulfil its obligations towards its creditors, and, in particular, no longer provides security for the assets entrusted to it by its depositors;
- (e) falls within one of the other cases where national law provides for withdrawal of authorisation; or
- (f) commits one of the breaches referred to in Article 67(1).

*Article 19***Name of credit institutions**

For the purposes of exercising their activities, credit institutions may, notwithstanding any provisions in the host Member State concerning the use of the words 'bank', 'savings bank' or other banking names, use throughout the territory of the Union the same name that they use in the Member State in which their head office is situated. In the event of there being any danger of

confusion, the host Member State may, for the purposes of clarification, require that the name be accompanied by certain explanatory particulars.

*Article 20***Notification of authorisation and withdrawal of authorisation**

1. Competent authorities shall notify EBA of every authorisation granted under Article 8.
2. EBA shall publish on its website, and shall update regularly, a list of the names of all credit institutions that have been granted authorisation.
3. The consolidating supervisor shall provide the competent authorities concerned and EBA with all information regarding the group of credit institutions in accordance with Article 14(3), Article 74(1) and Article 109(2), in particular regarding the legal and organisational structure of the group and its governance.
4. The list referred to in paragraph 2 of this Article shall include the names of credit institutions that do not have the capital specified in Article 12(1) and shall identify those credit institutions as such.
5. The competent authorities shall notify EBA of each withdrawal of authorisation together with the reasons for such a withdrawal.

*Article 21***Waiver for credit institutions permanently affiliated to a central body**

1. The competent authorities may waive the requirements set out in Articles 10 and 12 and Article 13(1) of this Directive with regard to a credit institution referred to in Article 10 of Regulation (EU) No 575/2013 in accordance with the conditions set out therein.

Member States may maintain and make use of existing national law regarding the application of such a waiver provided that it does not conflict with this Directive or with Regulation (EU) No 575/2013.

2. Where the competent authorities exercise a waiver referred to in paragraph 1, Articles 17, 33, 34 and 35, Article 36(1) to (3), Articles 39 to 46, Section II of Chapter 2 of Title VII and Chapter 4 of Title VII shall apply to the whole as constituted by the central body together with its affiliated institutions.

## CHAPTER 2

**Qualifying holding in a credit institution**

## Article 22

**Notification and assessment of proposed acquisitions**

1. Member States shall require any natural or legal person or such persons acting in concert (the "proposed acquirer"), who have taken a decision either to acquire, directly or indirectly, a qualifying holding in a credit institution or to further increase, directly or indirectly, such a qualifying holding in a credit institution as a result of which the proportion of the voting rights or of the capital held would reach or exceed 20 %, 30 % or 50 % or so that the credit institution would become its subsidiary (the "proposed acquisition"), to notify the competent authorities of the credit institution in which they are seeking to acquire or increase a qualifying holding in writing in advance of the acquisition, indicating the size of the intended holding and the relevant information, as specified in accordance with Article 23(4). Member States shall not be required to apply the 30 % threshold where, in accordance with Article 9(3)(a) of Directive 2004/109/EC, they apply a threshold of one-third.

2. The competent authorities shall acknowledge receipt of notification under paragraph 1 or of further information under paragraph 3 promptly and in any event within two working days following receipt in writing to the proposed acquirer.

The competent authorities shall have a maximum of 60 working days as from the date of the written acknowledgement of receipt of the notification and all documents required by the Member State to be attached to the notification on the basis of the list referred to in Article 23(4) (the "assessment period"), to carry out the assessment provided for in Article 23(1) (the "assessment").

The competent authorities shall inform the proposed acquirer of the date of the expiry of the assessment period at the time of acknowledging receipt.

3. The competent authorities may, during the assessment period if necessary, and no later than on the 50th working day of the assessment period, request further information that is necessary to complete the assessment. Such a request shall be made in writing and shall specify the additional information needed.

For the period between the date of request for information by the competent authorities and the receipt of a response thereto

by the proposed acquirer, the assessment period shall be suspended. The suspension shall not exceed 20 working days. Any further requests by the competent authorities for completion or clarification of the information shall be at their discretion but shall not result in a suspension of the assessment period.

4. The competent authorities may extend the suspension referred to in the second subparagraph of paragraph 3 up to 30 working days if the proposed acquirer is situated or regulated in a third country or is a natural or legal person not subject to supervision under this Directive or under Directives 2009/65/EC, 2009/138/EC, or 2004/39/EC.

5. If the competent authorities decide to oppose the proposed acquisition, they shall, within two working days of completion of the assessment, and not exceeding the assessment period, inform the proposed acquirer in writing, providing the reasons. Subject to national law, an appropriate statement of the reasons for the decision may be made accessible to the public at the request of the proposed acquirer. This shall not prevent a Member State from allowing the competent authority to publish such information in the absence of a request by the proposed acquirer.

6. If the competent authorities do not oppose the proposed acquisition within the assessment period in writing, it shall be deemed to be approved.

7. The competent authorities may fix a maximum period for concluding the proposed acquisition and extend it where appropriate.

8. Member States shall not impose requirements for notification to, or approval by, the competent authorities of direct or indirect acquisitions of voting rights or capital that are more stringent than those set out in this Directive.

9. EBA shall develop draft implementing technical standards to establish common procedures, forms and templates for the consultation process between the relevant competent authorities as referred to in Article 24.

EBA shall submit those draft implementing technical standards to the Commission by 31 December 2015.

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

### Article 23

#### Assessment criteria

1. In assessing the notification provided for in Article 22(1) and the information referred to in Article 22(3), the competent authorities shall, in order to ensure the sound and prudent management of the credit institution in which an acquisition is proposed, and having regard to the likely influence of the proposed acquirer on that credit institution, assess the suitability of the proposed acquirer and the financial soundness of the proposed acquisition in accordance with the following criteria:

- (a) the reputation of the proposed acquirer;
- (b) the reputation, knowledge, skills and experience, as set out in Article 91(1), of any member of the management body and any member of senior management who will direct the business of the credit institution as a result of the proposed acquisition;
- (c) the financial soundness of the proposed acquirer, in particular in relation to the type of business pursued and envisaged in the credit institution in which the acquisition is proposed;
- (d) whether the credit institution will be able to comply and continue to comply with the prudential requirements based on this Directive and Regulation (EU) No 575/2013, and where applicable, other Union law, in particular Directives 2002/87/EC and 2009/110/EC, including whether the group of which it will become a part has a structure that makes it possible to exercise effective supervision, effectively exchange information among the competent authorities and determine the allocation of responsibilities among the competent authorities;
- (e) whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing within the meaning of Article 1 of Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing<sup>(1)</sup> is being or has been committed or attempted, or that the proposed acquisition could increase the risk thereof.

2. The competent authorities may oppose the proposed acquisition only if there are reasonable grounds for doing so on the basis of the criteria set out in paragraph 1 or if the information provided by the proposed acquirer is incomplete.

3. Member States shall neither impose any prior conditions in respect of the level of holding that must be acquired nor

allow their competent authorities to examine the proposed acquisition in terms of the economic needs of the market.

4. Member States shall publish a list specifying the information that is necessary to carry out the assessment and that must be provided to the competent authorities at the time of notification referred to in Article 22(1). The information required shall be proportionate and adapted to the nature of the proposed acquirer and the proposed acquisition. Member States shall not require information that is not relevant for a prudential assessment.

5. Notwithstanding Article 22(2), (3) and (4), where two or more proposals to acquire or increase qualifying holdings in the same credit institution have been notified to the competent authority, the latter shall treat the proposed acquirers in a non-discriminatory manner.

### Article 24

#### Cooperation between competent authorities

1. The relevant competent authorities shall fully consult each other when carrying out the assessment if the proposed acquirer is one of the following:

- (a) a credit institution, insurance undertaking, reinsurance undertaking, investment firm, or a management company within the meaning of Article 2(1)(b) of Directive 2009/65/EC ("UCITS management company") authorised in another Member State or in a sector other than that in which the acquisition is proposed;
- (b) the parent undertaking of a credit institution, insurance undertaking, reinsurance undertaking, investment firm or UCITS management company authorised in another Member State or in a sector other than that in which the acquisition is proposed;
- (c) a natural or legal person controlling a credit institution, insurance undertaking, reinsurance undertaking, investment firm or UCITS management company authorised in another Member State or in a sector other than that in which the acquisition is proposed.

2. The competent authorities shall, without undue delay, provide each other with any information which is essential or relevant for the assessment. In that regard, the competent authorities shall communicate to each other upon request all relevant information and shall communicate on their own initiative all essential information. A decision by the competent authority that has authorised the credit institution in which the acquisition is proposed shall indicate any views or reservations expressed by the competent authority responsible for the proposed acquirer.

<sup>(1)</sup> OJ L 309, 25.11.2005, p. 15.

*Article 25***Notification in the case of a divestiture**

Member States shall require any natural or legal person who has taken a decision to dispose, directly or indirectly, of a qualifying holding in a credit institution to notify the competent authorities in writing in advance of the divestiture, indicating the size of the holding concerned. Such a person shall also notify the competent authorities if it has taken a decision to reduce its qualifying holding so that the proportion of the voting rights or of the capital held would fall below 20 %, 30 % or 50 % or so that the credit institution would cease to be its subsidiary. Member States shall not be required to apply the 30 % threshold where, in accordance with Article 9(3)(a) of Directive 2004/109/EC, they apply a threshold of one-third.

*Article 26***Information obligations and penalties**

1. Credit institutions shall, on becoming aware of any acquisitions or disposals of holdings in their capital that cause holdings to exceed or fall below one of the thresholds referred to in Article 22(1) and Article 25, inform the competent authorities of those acquisitions or disposals.

Credit institutions admitted to trading on a regulated market shall, at least annually, inform the competent authorities of the names of shareholders and members possessing qualifying holdings and the sizes of such holdings as shown, for example, by the information received at the annual general meetings of shareholders and members or as a result of compliance with the regulations relating to companies admitted to trading on a regulated market.

2. Member States shall require that, where the influence exercised by the persons referred to in Article 22(1) is likely to operate to the detriment of the prudent and sound management of the institution, the competent authorities shall take appropriate measures to put an end to that situation. Such measures may consist in injunctions, penalties, subject to Articles 65 to 72, against members of the management body and managers, or the suspension of the exercise of the voting rights attached to the shares held by the shareholders or members of the credit institution in question.

Similar measures shall apply to natural or legal persons who fail to comply with the obligation to provide prior information as set out in Article 22(1) and subject to Articles 65 to 72.

If a holding is acquired despite opposition by the competent authorities, Member States shall, regardless of any other penalty to be adopted, provide either for exercise of the corresponding voting rights to be suspended, or for the nullity of votes cast or for the possibility of their annulment.

*Article 27***Criteria for qualifying holdings**

In determining whether the criteria for a qualifying holding as referred to in Articles 22, 25 and 26 are fulfilled, the voting rights referred to in Articles 9, 10 and 11 of Directive 2004/109/EC and the conditions regarding aggregation thereof set out in Article 12(4) and (5) of that Directive, shall be taken into account.

In determining whether the criteria for a qualifying holding as referred to in Article 26 are fulfilled, Member States shall not take into account voting rights or shares which institutions may hold as a result of providing the underwriting of financial instruments or placing of financial instruments on a firm commitment basis included under point 6 of Section A of Annex I to Directive 2004/39/EC, provided that those rights are not exercised or otherwise used to intervene in the management of the issuer and are disposed of within one year of acquisition.

## TITLE IV

**INITIAL CAPITAL OF INVESTMENT FIRMS***Article 28***Initial capital of investment firms**

1. The initial capital of investment firms shall comprise only one or more of the items referred to in points (a) to (e) of Article 26(1) of Regulation (EU) No 575/2013.

2. All investment firms other than those referred to in Article 29 shall have initial capital of EUR 730 000.

*Article 29***Initial capital of particular types of investment firms**

1. An investment firm that does not deal in any financial instruments for its own account or underwrite issues of financial instruments on a firm commitment basis, but which holds client money or securities and which offers one or more of the following services, shall have initial capital of EUR 125 000:

- (a) the reception and transmission of investors' orders for financial instruments;
- (b) the execution of investors' orders for financial instruments;
- (c) the management of individual portfolios of investments in financial instruments.

2. The competent authorities may allow an investment firm which executes investors' orders for financial instruments to hold such instruments for its own account if the following conditions are met:

- (a) such positions arise only as a result of the firm's failure to match investors' orders precisely;
- (b) the total market value of all such positions is subject to a ceiling of 15 % of the firm's initial capital;
- (c) the firm meets the requirements set out in Articles 92 to 95 and Part Four of Regulation (EU) No 575/2013;
- (d) such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.

3. Member States may reduce the amount referred to in paragraph 1 to EUR 50 000 where a firm is not authorised to hold client money or securities, to deal for its own account, or to underwrite issues on a firm commitment basis.

4. The holding of non-trading-book positions in financial instruments in order to invest own funds shall not be considered as dealing for its own account in relation to the services set out in paragraph 1 or for the purposes of paragraph 3.

#### Article 30

##### Initial capital of local firms

Local firms shall have initial capital of EUR 50 000 insofar as they benefit from the freedom of establishment or to provide services specified in Articles 31 and 32 of Directive 2004/39/EC.

#### Article 31

##### Coverage for firms not authorised to hold client money or securities

1. Coverage for the firms referred to in point (2)(c) of Article 4(1) of Regulation (EU) No 575/2013 shall take one of the following forms:

- (a) initial capital of EUR 50 000;
- (b) professional indemnity insurance covering the whole territory of the Union or some other comparable guarantee against liability arising from professional negligence, representing at least EUR 1 000 000 applying to each claim and in aggregate EUR 1 500 000 per annum for all claims;

- (c) a combination of initial capital and professional indemnity insurance in a form resulting in a level of coverage equivalent to that referred to in points (a) or (b).

The Commission shall periodically review the amounts referred to in the first subparagraph.

2. If a firm referred to in point (2)(c) of Article 4(1) of Regulation (EU) No 575/2013 is also registered under Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation<sup>(1)</sup>, it shall comply with Article 4(3) of that Directive and have coverage in one of the following forms:

- (a) initial capital of EUR 25 000;
- (b) professional indemnity insurance covering the whole territory of the Union or some other comparable guarantee against liability arising from professional negligence, representing at least EUR 500 000 applying to each claim and in aggregate EUR 750 000 per annum for all claims;
- (c) a combination of initial capital and professional indemnity insurance in a form resulting in a level of coverage equivalent to that referred to in points (a) or (b).

#### Article 32

##### Grandfathering provision

1. By way of derogation from Article 28(2), Article 29(1) and (3) and Article 30, Member States may continue authorising investment firms and firms covered by Article 30 which were in existence on or before 31 December 1995, the own funds of which are less than the initial capital levels specified for them in Article 28(2), Article 29(1) or (3) or Article 30.

The own funds of such investment firms or firms shall not fall below the highest reference level calculated after 23 March 1993. 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.

2. If control of an investment firm or a firm covered by paragraph 1 is taken by a natural or legal person other than the person who controlled it on or before 31 December 1995, the own funds of that investment firm or firm shall attain at least the level specified for them in Article 28(2), Article 29(1) or (3), or Article 30, except in the case of a first transfer by inheritance made after 31 December 1995, subject to the approval of the competent authorities and for a period of not more than 10 years from the date of that transfer.

<sup>(1)</sup> OJ L 9, 15.1.2003, p. 3.



3. In the event of a merger of two or more investment firms or firms covered by Article 30, the own funds of the firm resulting from the merger need not attain the level specified in Article 28(2), Article 29(1) or (3) or Article 30. Nevertheless, during any period when the level specified in Article 28(2), Article 29(1) or (3) or Article 30 has not been attained, the own funds of the firm resulting from the merger shall not fall below the total own funds of the merged firms at the time of the merger.

4. The own funds of investment firms and firms covered by Article 30 shall not fall below the levels specified in Article 28(2), Article 29(1) or (3) or Article 30 and in paragraphs 1 and 3 of this Article.

5. Where competent authorities consider it necessary, in order to ensure the solvency of such investment firms and firms, that the requirements set out in paragraph 4 are met, paragraphs 1, 2 and 3 shall not apply.

#### TITLE V

### PROVISIONS CONCERNING THE FREEDOM OF ESTABLISHMENT AND THE FREEDOM TO PROVIDE SERVICES

#### CHAPTER 1

#### *General Principles*

##### *Article 33*

#### **Credit institutions**

Member States shall provide that the activities listed in Annex I may be carried out within their territories, in accordance with Article 35, Article 36(1), (2) and (3), Article 39(1) and (2) and Articles 40 to 46 either by establishing a branch or by providing services, by any credit institution authorised and supervised by the competent authorities of another Member State, provided that such activities are covered by the authorisation.

##### *Article 34*

#### **Financial institutions**

1. Member States shall provide that the activities listed in Annex I may be carried out within their territories, in accordance with Article 35, Article 36(1), (2) and (3), Article 39(1) and (2) and Articles 40 to 46, either by establishing a branch or by providing services, by any financial institution from another Member State, whether a subsidiary of a credit institution or the jointly owned subsidiary of two or more credit institutions, the memorandum and Articles of association of which permit the carrying out of those activities and which fulfils each of the following conditions:

(a) the parent undertaking or undertakings are authorised as credit institutions in the Member State by the law of which the financial institution is governed;

(b) the activities in question are actually carried out within the territory of the same Member State;

(c) the parent undertaking or undertakings holds 90 % or more of the voting rights attaching to shares in the capital of the financial institution;

(d) the parent undertaking or undertakings satisfies the competent authorities regarding the prudent management of the financial institution and has declared, with the consent of the relevant home Member State competent authorities, that they jointly and severally guarantee the commitments entered into by the financial institution;

(e) the financial institution is effectively included, for the activities in question in particular, in the consolidated supervision of the parent undertaking, or of each of the parent undertakings, in accordance with Title VII, Chapter 3 of this Directive and Part One, Title II, Chapter 2 of Regulation (EU) No 575/2013, in particular for the purposes of the own funds requirements set out in Article 92 of that Regulation, for the control of large exposures provided for in Part Four of that Regulation and for the purposes of the limitation of holdings provided for in Articles 89 and 90 of that Regulation.

The competent authorities of the home Member State shall check compliance with the conditions set out in the first subparagraph and shall supply the financial institution with a certificate of compliance which shall form part of the notification referred to in Articles 35 and 39.

2. If a financial institution as referred to in the first subparagraph of paragraph 1 ceases to fulfil any of the conditions imposed, the competent authorities of the home Member State shall notify the competent authorities of the host Member State and the activities carried out by that financial institution in the host Member State shall become subject to the law of the host Member State.

3. Paragraphs 1 and 2 shall apply accordingly to subsidiaries of a financial institution as referred to in the first subparagraph of paragraph 1.

#### CHAPTER 2

### *The right of establishment of credit institutions*

#### *Article 35*

#### **Notification requirement and interaction between competent authorities**

1. A credit institution wishing to establish a branch within the territory of another Member State shall notify the competent authorities of its home Member State.

2. Member States shall require every credit institution wishing to establish a branch in another Member State to provide all the following information when effecting the notification referred to in paragraph 1:

- (a) the Member State within the territory of which it plans to establish a branch;
- (b) a programme of operations setting out, inter alia, the types of business envisaged and the structural organisation of the branch;
- (c) the address in the host Member State from which documents may be obtained;
- (d) the names of those to be responsible for the management of the branch.

3. Unless the competent authorities of the home Member State have reason to doubt the adequacy of the administrative structure or the financial situation of the credit institution, taking into account the activities envisaged, they shall, within three months of receipt of the information referred to in paragraph 2, communicate that information to the competent authorities of the host Member State and shall inform the credit institution accordingly.

The home Member State's competent authorities shall also communicate the amount and composition of own funds and the sum of the own funds requirements under Article 92 of Regulation (EU) No 575/2013 of the credit institution.

By way of derogation from the second subparagraph, in the case referred to in Article 34 the home Member State's competent authorities shall communicate the amount and composition of own funds of the financial institution and the total risk exposure amounts calculated in accordance with Article 92(3) and (4) of Regulation (EU) No 575/2013 of the credit institution which is its parent undertaking.

4. Where the competent authorities of the home Member State refuse to communicate the information referred to in paragraph 2 to the competent authorities of the host Member State, they shall give reasons for their refusal to the credit institution concerned within three months of receipt of all the information.

That refusal or a failure to reply shall be subject to a right to apply to the courts in the home Member State.

5. EBA shall develop draft regulatory technical standards to specify the information to be notified in accordance with this Article.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in

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

6. EBA shall develop draft implementing technical standards to establish standard forms, templates and procedures for such notification.

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

7. EBA shall submit the draft technical standards referred to in paragraphs 5 and 6 to the Commission by 1 January 2014.

### Article 36

#### Commencement of activities

1. Before the branch of a credit institution commences its activities the competent authorities of the host Member State shall, within two months of receiving the information referred to in Article 35, prepare for the supervision of the credit institution in accordance with Chapter 4 and if necessary indicate the conditions under which, in the interests of the general good, those activities shall be carried out in the host Member State.

2. On receipt of a communication from the competent authorities of the host Member State, or in the event of the expiry of the period provided for in paragraph 1 without receipt of any communication from the latter, the branch may be established and may commence its activities.

3. In the event of a change in any of the information communicated pursuant to points (b), (c) or (d) of Article 35(2), a credit institution shall give written notice of the change in question to the competent authorities of the home and host Member States at least one month before making the change in order to enable the competent authorities of the home Member State to take a decision following a notification under Article 35, and the competent authorities of the host Member State to take a decision setting out the conditions for the change pursuant to paragraph 1 of this Article.

4. Branches which have commenced their activities, in accordance with the provisions in force in their host Member States, before 1 January 1993, shall be presumed to have been subject to the procedures set out in Article 35 and in paragraphs 1 and 2 of this Article. They shall be governed, from 1 January 1993, by paragraph 3 of this Article and by Articles 33 and 52 and Chapter 4.

5. EBA shall develop draft regulatory technical standards to specify the information to be notified in accordance with this Article.

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

6. EBA shall develop draft implementing technical standards to establish standard forms, templates and procedures for such notification.

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

7. EBA shall submit the draft technical standards referred to in paragraphs 5 and 6 to the Commission by 1 January 2014.

#### Article 37

##### **Information about refusals**

Member States shall inform the Commission and EBA of the number and type of cases in which there has been a refusal pursuant to Article 35 and Article 36(3).

#### Article 38

##### **Aggregation of branches**

Any number of places of business set up in the same Member State by a credit institution with headquarters in another Member State shall be regarded as a single branch.

#### CHAPTER 3

##### **Exercise of the freedom to provide services**

#### Article 39

##### **Notification procedure**

1. Any credit institution wishing to exercise the freedom to provide services by carrying out its activities within the territory of another Member State for the first time shall notify the competent authorities of the home Member State of the activities on the list in Annex I which it intends to carry out.

2. The competent authorities of the home Member State shall, within one month of receipt of the notification provided for in paragraph 1, send that notification to the competent authorities of the host Member State.

3. This Article shall not affect rights acquired by credit institutions providing services before 1 January 1993.

4. EBA shall develop draft regulatory technical standards to specify the information to be notified in accordance with this Article.

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

5. EBA shall develop draft implementing technical standards to establish standard forms, templates and procedures for such notification.

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

6. EBA shall submit the draft technical standards referred to in paragraphs 4 and 5 to the Commission by 1 January 2014.

#### CHAPTER 4

##### **Powers of the competent authorities of the host Member State**

#### Article 40

##### **Reporting requirements**

The competent authorities of the host Member States may require that all credit institutions having branches within their territories shall report to them periodically on their activities in those host Member States.

Such reports shall only be required for information or statistical purposes, for the application of Article 51(1), or for supervisory purposes in accordance with this Chapter. They shall be subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1).

The competent authorities of the host Member States may in particular require information from the credit institutions referred to in the first subparagraph in order to allow those competent authorities to assess whether a branch is significant in accordance with Article 51(1).

#### Article 41

##### **Measures taken by the competent authorities of the home Member State in relation to activities carried out in the host Member State**

1. Where the competent authorities of the host Member State on the basis of information received from the competent authorities of the home Member State under Article 50 ascertain that a credit institution having a branch or providing services within its territory fulfils one of the following conditions in relation to the activities carried out in that host Member State, they shall inform the competent authorities of the home Member State:

(a) the credit institution does not comply with the national provisions transposing this Directive or with Regulation (EU) No 575/2013;

(b) there is a material risk that the credit institution will not comply with the national provisions transposing this Directive or with Regulation (EU) No 575/2013.

The competent authorities of the home Member State shall, without delay, take all appropriate measures to ensure that the credit institution concerned remedies its non-compliance or takes measures to avert the risk of non-compliance. The competent authorities of the home Member State shall communicate those measures to the competent authorities of the host Member State without delay.

2. Where the competent authorities of the host Member State consider that the competent authorities of the home Member State have not fulfilled their obligations or will not fulfil their obligations pursuant to the second subparagraph of paragraph 1, they may refer the matter to EBA and request its assistance in accordance with Article 19 of Regulation (EU) No 1093/2010. Where EBA acts in accordance with that Article, it shall take any decision under Article 19(3) of that Regulation within 24 hours. EBA may also assist the competent authorities in reaching an agreement on its own initiative in accordance with the second subparagraph of Article 19(1) of that Regulation.

#### Article 42

##### Reasons and communication

Any measure taken pursuant to Article 41(1), or Article 43 or 44 involving penalties or restrictions on the exercise of the freedom to provide services or the freedom of establishment shall be properly reasoned and communicated to the credit institution concerned.

#### Article 43

##### Precautionary measures

1. Before following the procedure set out in Article 41, the competent authorities of the host Member State may, in emergency situations, pending measures by the competent authorities of the home Member State or reorganisation measures referred to in Article 3 of Directive 2001/24/EC, take any precautionary measures necessary to protect against financial instability that would seriously threaten the collective interests of depositors, investors and clients in the host Member State.

2. Any precautionary measures under paragraph 1 shall be proportionate to their purpose to protect against financial instability that would seriously threaten collective interests of depositors, investors and clients in the host Member State. Such precautionary measures may include a suspension of payment. They shall not result in a preference for the creditors of the credit institution in the host Member State over creditors in other Member States.

3. Any precautionary measure under paragraph 1 shall cease to have effect when the administrative or judicial authorities of

the home Member State take reorganisation measures under Article 3 of Directive 2001/24/EC.

4. The competent authorities of the host Member State shall terminate precautionary measures where they consider those measures to have become obsolete under Article 41, unless they cease to have effect in accordance with paragraph 3 of this Article.

5. The Commission, EBA and the competent authorities of the other Member States concerned shall be informed of precautionary measures taken under paragraph 1 without undue delay.

Where the competent authorities of the home Member State or of any other affected Member State object to measures taken by the competent authorities of the host Member State, they may refer the matter to EBA and request its assistance in accordance with Article 19 of Regulation (EU) No 1093/2010. Where EBA acts in accordance with that Article, it shall take any decision under Article 19(3) of that Regulation within 24 hours. EBA may also assist the competent authorities in reaching an agreement on its own initiative in accordance with the second subparagraph of Article 19(1) of that Regulation.

#### Article 44

##### Powers of host Member States

Host Member States may, notwithstanding Articles 40 and 41, exercise the powers conferred on them under this Directive to take appropriate measures to prevent or to punish breaches committed within their territories of the rules they have adopted pursuant to this Directive or in the interests of the general good. This shall include the possibility of preventing offending credit institutions from initiating further transactions within their territories.

#### Article 45

##### Measures following withdrawal of authorisation

In the event of withdrawal of authorisation, the competent authorities of the home Member State shall inform the competent authorities of the host Member State without delay. The competent authorities of the host Member State shall take appropriate measures to prevent the credit institution concerned from initiating further transactions within its territory and to safeguard the interests of depositors.

#### Article 46

##### Advertising

Nothing in this Chapter shall prevent credit institutions with head offices in other Member States from advertising their services through all available means of communication in the host Member State, subject to any rules governing the form and the content of such advertising adopted in the interests of the general good.

## TITLE VI

**RELATIONS WITH THIRD COUNTRIES***Article 47***Notification in relation to third-country branches and conditions of access for credit institutions with such branches**

1. Member States shall not apply to branches of credit institutions having their head office in a third country, when commencing or continuing to carry out their business, provisions which result in more favourable treatment than that accorded to branches of credit institutions having their head office in the Union.

2. The competent authorities shall notify the Commission, EBA and the European Banking Committee established by Commission Decision 2004/10/EC <sup>(1)</sup> of all authorisations for branches granted to credit institutions having their head office in a third country.

3. The Union may, through agreements concluded with one or more third countries, agree to apply provisions which accord to branches of a credit institution having its head office in a third country identical treatment throughout the territory of the Union.

*Article 48***Cooperation with supervisory authorities of third countries regarding supervision on a consolidated basis**

1. The Commission may submit proposals to the Council, either at the request of a Member State or on its own initiative, for the negotiation of agreements with one or more third countries regarding the means of exercising supervision on a consolidated basis over the following:

- (a) institutions the parent undertakings of which have their head offices in a third country;
- (b) institutions situated in third countries the parent undertakings of which, whether institutions, financial holding companies or mixed financial holding companies, have their head offices in the Union.

2. The agreements referred to in paragraph 1 shall, in particular, seek to ensure that:

- (a) the competent authorities of the Member States are able to obtain the information necessary for the supervision, on the basis of their consolidated financial situations, of institutions, financial holding companies and mixed financial

holding companies situated in the Union which have as subsidiaries institutions or financial institutions situated in a third country, or holding participation therein;

- (b) the supervisory authorities of third countries are able to obtain the information necessary for the supervision of parent undertakings the head offices of which are situated within their territories and which have as subsidiaries institutions or financial institutions situated in one or more Member States or holding participation therein; and

- (c) EBA is able to obtain from the competent authorities of the Member States the information received from national authorities of third countries in accordance with Article 35 of Regulation (EU) No 1093/2010.

3. Without prejudice to Article 218 TFEU, the Commission shall, with the assistance of the European Banking Committee, examine the outcome of the negotiations referred to in paragraph 1 and the resulting situation.

4. EBA shall assist the Commission for the purposes of this Article in accordance with Article 33 of Regulation (EU) No 1093/2010.

## TITLE VII

**PRUDENTIAL SUPERVISION**

## CHAPTER 1

***Principles of prudential supervision***

## Section I

**Competence and duties of home and host Member States***Article 49***Competence of the competent authorities of the home and host Member States**

1. The prudential supervision of an institution, including that of the activities it carries out in accordance with Articles 33 and 34, shall be the responsibility of the competent authorities of the home Member State, without prejudice to those provisions of this Directive which give responsibility to the competent authorities of the host Member State.

2. Paragraph 1 shall not prevent supervision on a consolidated basis.

3. Measures taken by the host Member State shall not allow discriminatory or restrictive treatment on the basis that an institution is authorised in another Member State.

<sup>(1)</sup> OJ L 3, 7.1.2004, p. 36.



*Article 50***Collaboration concerning supervision**

1. The competent authorities of the Member States concerned shall collaborate closely in order to supervise the activities of institutions operating, in particular through a branch, in one or more Member States other than that in which their head offices are situated. They shall supply one another with all information concerning the management and ownership of such institutions that is likely to facilitate their supervision and the examination of the conditions for their authorisation, and all information likely to facilitate the monitoring of institutions, in particular with regard to liquidity, solvency, deposit guarantee, the limiting of large exposures, other factors that may influence the systemic risk posed by the institution, administrative and accounting procedures and internal control mechanisms.

2. The competent authorities of the home Member State shall provide the competent authorities of host Member States immediately with any information and findings pertaining to liquidity supervision in accordance with Part Six of Regulation (EU) No 575/2013 and Title VII, Chapter 3 of this Directive of the activities performed by the institution through its branches, to the extent that such information and findings are relevant to the protection of depositors or investors in the host Member State.

3. The competent authorities of the home Member State shall inform the competent authorities of all host Member States immediately where liquidity stress occurs or can reasonably be expected to occur. That information shall also include details about the planning and implementation of a recovery plan and about any prudential supervision measures taken in that context.

4. The competent authorities of the home Member State shall communicate and explain upon request to the competent authorities of the host Member State how information and findings provided by the latter have been taken into account. Where, following communication of information and findings, the competent authorities of the host Member State maintain that no appropriate measures have been taken by the competent authorities of the home Member State, the competent authorities of the host Member State may, after informing the competent authorities of the home Member State and EBA, take appropriate measures to prevent further breaches in order to protect the interests of depositors, investors and others to whom services are provided or to protect the stability of the financial system.

Where the competent authorities of the home Member State disagree with the measures to be taken by the competent authorities of the host Member State, they may refer the matter to EBA and request its assistance in accordance with Article 19 of Regulation (EU) No 1093/2010. Where EBA acts in accordance with that Article, it shall take any decision within one month.

5. The competent authorities may refer to EBA situations where a request for collaboration, in particular to exchange

information, has been rejected or has not been acted upon within a reasonable time. Without prejudice to Article 258 TFEU, EBA may, in those situations, act in accordance with the powers conferred on it under Article 19 of Regulation (EU) No 1093/2010. EBA may also assist the competent authorities in reaching an agreement on the exchange of information under this Article on its own initiative in accordance with the second subparagraph of Article 19(1) of that Regulation.

6. EBA shall develop draft regulatory technical standards to specify the information referred to in this Article.

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

7. EBA shall develop draft implementing technical standards to establish standard forms, templates and procedures for the information sharing requirements which are likely to facilitate the monitoring of institutions.

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

8. EBA shall submit the draft technical standards referred to in paragraphs 6 and 7 to the Commission by 1 January 2014.

*Article 51***Significant branches**

1. The competent authorities of a host Member State may make a request to the consolidating supervisor, where Article 112(1) applies, or to the competent authorities of the home Member State for a branch of an institution other than an investment firm subject to Article 95 of Regulation (EU) No 575/2013 to be considered as significant.

That request shall provide reasons for considering the branch to be significant with particular regard to the following:

- (a) whether the market share of the branch in terms of deposits exceeds 2 % in the host Member State;
- (b) the likely impact of a suspension or closure of the operations of the institution on systemic liquidity and the payment, clearing and settlement systems in the host Member State;

- (c) the size and the importance of the branch in terms of number of clients within the context of the banking or financial system of the host Member State.

The competent authorities of the home and host Member States, and, where Article 112(1) applies, the consolidating supervisor, shall do everything within their power to reach a joint decision on the designation of a branch as being significant.

If no joint decision is reached within two months of receipt of a request under the first subparagraph, the competent authorities of the host Member State shall take their own decision within a further period of two months on whether the branch is significant. In taking their decision, the competent authorities of the host Member State shall take into account any views and reservations of the consolidating supervisor or the competent authorities of the home Member State.

The decisions referred to in the third and fourth subparagraphs shall be set out in a document containing full reasons, shall be transmitted to the competent authorities concerned and shall be recognised as determinative and applied by the competent authorities in the Member States concerned.

The designation of a branch as being significant shall not affect the rights and responsibilities of the competent authorities under this Directive.

2. The competent authorities of the home Member State shall communicate to the competent authorities of a host Member State where a significant branch is established the information referred to in Article 117(1)(c) and (d) and carry out the tasks referred to in Article 112(1)(c) in cooperation with the competent authorities of the host Member State.

If a competent authority of a home Member State becomes aware of an emergency situation as referred to in Article 114(1), it shall alert without delay the authorities referred to in Article 58(4) and Article 59(1).

The competent authorities of the home Member State shall communicate to the competent authorities of the host Member States where significant branches are established the results of the risk assessments of institutions with such branches referred to in Article 97 and, where applicable, Article 113(2). They shall also communicate decisions under Articles 104 and 105 in so far as those assessments and decisions are relevant to those branches.

The competent authorities of the home Member States shall consult the competent authorities of the host Member States where significant branches are established about operational steps required by Article 86(11), where relevant for liquidity risks in the host Member State's currency.

Where the competent authorities of the home Member State have not consulted the competent authorities of the host Member State, or where, following such consultation, the competent authorities of the host Member State maintain that operational steps required by Article 86(11) are not adequate, the competent authorities of the host Member State may refer the matter to EBA and request its assistance in accordance with Article 19 of Regulation (EU) No 1093/2010.

3. Where Article 116 does not apply, the competent authorities supervising an institution with significant branches in other Member States shall establish and chair a college of supervisors to facilitate the cooperation under paragraph 2 of this Article and under Article 50. The establishment and functioning of the college shall be based on written arrangements to be determined, after consulting the competent authorities concerned, by the competent authority of the home Member State. The competent authority of the home Member State shall decide which competent authorities participate in a meeting or in an activity of the college.

The decision of the competent authority of the home Member State shall take account of the relevance of the supervisory activity to be planned or coordinated for those authorities, in particular the potential impact on the stability of the financial system in the Member States concerned referred to in Article 7 and the obligations referred to in paragraph 2 of this Article.

The competent authority of the home Member State shall keep all members of the college fully informed, in advance, of the organisation of such meetings, the main issues to be discussed and the activities to be considered. The competent authority of the home Member State shall also keep all the members of the college fully informed, in a timely manner, of the actions taken in those meetings or the measures carried out.

4. EBA shall develop draft regulatory technical standards in order to specify general conditions for the functioning of colleges of supervisors.

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

5. EBA shall develop draft implementing technical standards in order to determine the operational functioning of colleges of supervisors.

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

6. EBA shall submit the draft technical standards referred to in paragraphs 4 and 5 to the Commission by 31 December 2014.

#### Article 52

##### **On-the-spot checking and inspection of branches established in another Member State**

1. Host Member States shall provide that, where an institution authorised in another Member State carries out its activities through a branch, the competent authorities of the home Member State may, after having informed the competent authorities of the host Member State, carry out themselves or through the intermediary of persons they appoint for that purpose on-the-spot checks of the information referred to in Article 50 and inspections of such branches.

2. The competent authorities of the home Member State may also, for the purposes of the inspection of branches, have recourse to one of the other procedures set out in Article 118.

3. The competent authorities of the host Member State shall have the power to carry out, on a case-by-case basis, on-the-spot checks and inspections of the activities carried out by branches of institutions on their territory and require information from a branch about its activities and for supervisory purposes, where they consider it relevant for reasons of stability of the financial system in the host Member State. Before carrying out such checks and inspections, the competent authorities of the host Member State shall consult the competent authorities of the home Member State. After such checks and inspections, the competent authorities of the host Member State shall communicate to the competent authorities of the home Member State the information obtained and findings that are relevant for the risk assessment of the institution or the stability of the financial system in the host Member State. The competent authorities of the home Member State shall duly take into account that information and those findings in determining their supervisory examination programme referred to in Article 99, also having regard to the stability of the financial system in the host Member State.

4. The on-the-spot checks and inspections of branches shall be conducted in accordance with the law of the Member State where the check or inspection is carried out.

#### Section II

##### **Exchange of information and professional secrecy**

#### Article 53

##### **Professional secrecy**

1. Member States shall provide that all persons working for or who have worked for the competent authorities and auditors

or experts acting on behalf of the competent authorities shall be bound by the obligation of professional secrecy.

Confidential information which such persons, auditors or experts receive in the course of their duties may be disclosed only in summary or aggregate form, such that individual credit institutions cannot be identified, without prejudice to cases covered by criminal law.

Nevertheless, where a credit institution has been declared bankrupt or is being compulsorily wound up, confidential information which does not concern third parties involved in attempts to rescue that credit institution may be disclosed in civil or commercial proceedings.

2. Paragraph 1 shall not prevent the competent authorities from exchanging information with each other or transmitting information to the ESRB, EBA, or the European Supervisory Authority (European Securities and Markets Authority) ("ESMA") established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council<sup>(1)</sup> in accordance with this Directive, with Regulation (EU) No 575/2013, with other Directives applicable to credit institutions, with Article 15 of Regulation (EU) No 1092/2010, with Articles 31, 35 and 36 of Regulation (EU) No 1093/2010 and with Articles 31 and 36 of Regulation (EU) No 1095/2010. That information shall be subject to paragraph 1.

3. Paragraph 1 shall not prevent the competent authorities from publishing the outcome of stress tests carried out in accordance with Article 100 of this Directive or Article 32 of Regulation (EU) No 1093/2010 or from transmitting the outcome of stress tests to EBA for the purpose of the publication by EBA of the results of Union-wide stress tests.

#### Article 54

##### **Use of confidential information**

Competent authorities receiving confidential information under Article 53 shall use it only in the course of their duties and only for any of the following purposes:

- (a) to check that the conditions governing access to the activity of credit institutions are met and to facilitate monitoring, on a non-consolidated or consolidated basis, of the conduct of such activity, especially with regard to the monitoring of liquidity, solvency, large exposures, and administrative and accounting procedures and internal control mechanisms;
- (b) to impose penalties;
- (c) in an appeal against a decision of the competent authority including court proceedings pursuant to Article 72;

<sup>(1)</sup> OJ L 331, 15.12.2010, p. 84.

- (d) in court proceedings initiated pursuant to special provisions provided for in Union law adopted in the field of credit institutions.

#### Article 55

##### Cooperation agreements

Member States and EBA, in accordance with Article 33 of Regulation (EU) No 1093/2010, may conclude cooperation agreements, providing for exchanges of information, with the supervisory authorities of third countries or with authorities or bodies of third countries in accordance with Article 56 and Article 57(1) of this Directive only if the information disclosed is subject to a guarantee that professional secrecy requirements at least equivalent to those referred to in Article 53(1) of this Directive are complied with. Such exchange of information shall be for the purpose of performing the supervisory tasks of those authorities or bodies.

Where the information originates in another Member State, it shall only be disclosed with the express agreement of the authorities which have disclosed it and, where appropriate, solely for the purposes for which those authorities gave their agreement.

#### Article 56

##### Exchange of information between authorities

Article 53(1) and Article 54 shall not preclude the exchange of information between competent authorities within a Member State, between competent authorities in different Member States or between competent authorities and the following, in the discharge of their supervisory functions:

- (a) authorities entrusted with the public duty of supervising other financial sector entities and the authorities responsible for the supervision of financial markets;
- (b) authorities or bodies charged with responsibility for maintaining the stability of the financial system in Member States through the use of macroprudential rules;
- (c) reorganisation bodies or authorities aiming at protecting the stability of the financial system;
- (d) contractual or institutional protection schemes as referred to in Article 113(7) of Regulation (EU) No 575/2013;
- (e) bodies involved in the liquidation and bankruptcy of institutions and in other similar procedures;
- (f) persons responsible for carrying out statutory audits of the accounts of institutions, insurance undertakings and financial institutions.

Article 53(1) and Article 54 shall not preclude the disclosure to bodies which administer deposit-guarantee schemes and investor compensation schemes of information necessary for the exercise of their functions.

The information received shall in any event be subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1).

#### Article 57

##### Exchange of information with oversight bodies

1. Notwithstanding Articles 53, 54 and 55, Member States may authorise exchange of information between the competent authorities and the authorities responsible for overseeing:

- (a) the bodies involved in the liquidation and bankruptcy of institutions and in other similar procedures;
- (b) contractual or institutional protection schemes as referred to in Article 113(7) of Regulation (EU) No 575/2013;
- (c) persons charged with carrying out statutory audits of the accounts of institutions, insurance undertakings and financial institutions.

2. In the cases referred to in paragraph 1, Member States shall require fulfilment of at least the following conditions:

- (a) that the information is exchanged for the purpose of performing the tasks referred to in paragraph 1;
- (b) that the information received is subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1);
- (c) where the information originates in another Member State, that it is not disclosed without the express agreement of the competent authorities which have disclosed it and, where appropriate, solely for the purposes for which those authorities gave their agreement.

3. Notwithstanding Articles 53, 54 and 55, Member States may, with the aim of strengthening the stability and integrity of the financial system, authorise the exchange of information between competent authorities and the authorities or bodies responsible under law for the detection and investigation of breaches of company law.



In such cases Member States shall require fulfilment of at least the following conditions:

- (a) that the information is exchanged for the purpose of detecting and investigating breaches of company law;
- (b) that the information received is subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1);
- (c) where the information originates in another Member State, that it is not disclosed without the express agreement of the competent authorities which have disclosed it and, where appropriate, solely for the purposes for which those authorities gave their agreement.

4. Where the authorities or bodies referred to in paragraph 1 perform their task of detection or investigation with the aid, in view of their specific competence, of persons appointed for that purpose and not employed in the public sector, a Member State may extend the possibility of exchanging information provided for in the first subparagraph of paragraph 3 to such persons under the conditions specified in the second subparagraph of paragraph 3.

5. The competent authorities shall communicate to EBA the names of the authorities or bodies which may receive information pursuant to this Article.

6. In order to implement paragraph 4, the authorities or bodies referred to in paragraph 3 shall communicate to the competent authorities which have disclosed the information, the names and precise responsibilities of the persons to whom it is to be sent.

#### Article 58

##### **Transmission of information concerning monetary, deposit protection, systemic and payment aspects**

1. Nothing in this Chapter shall prevent a competent authority from transmitting information to the following for the purposes of their tasks:

- (a) ESCB central banks and other bodies with a similar function in their capacity as monetary authorities when the information is relevant for the exercise of their respective statutory tasks, including the conduct of monetary policy and related liquidity provision, oversight of payments, clearing and settlement systems and the safeguarding of stability of the financial system;
- (b) contractual or institutional protection schemes as referred to in Article 113(7) of Regulation (EU) No 575/2013;

(c) where appropriate, other public authorities responsible for overseeing payment systems;

(d) the ESRB, the European Supervisory Authority (European Insurance and Occupational Pensions Authority) ("EIOPA"), established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council<sup>(1)</sup> and ESMA, where that information is relevant for the exercise of their tasks under Regulations (EU) No 1092/2010, (EU) No 1094/2010 or (EU) No 1095/2010.

Member States shall take the appropriate measures to remove obstacles preventing competent authorities from transmitting information in accordance with the first subparagraph.

2. Nothing in this Chapter shall prevent the authorities or bodies referred to in paragraph 1 from communicating to the competent authorities such information as the competent authorities may need for the purposes of Article 54.

3. Information received in accordance with paragraphs 1 and 2 shall be subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1).

4. Member States shall take the necessary measures to ensure that, in an emergency situation as referred to in Article 114(1), the competent authorities communicate, without delay, information to the ESCB central banks where that information is relevant for the exercise of their statutory tasks, including the conduct of monetary policy and related liquidity provision, the oversight of payments, clearing and settlement systems, and the safeguarding of the stability of the financial system, and to the ESRB where such information is relevant for the exercise of its statutory tasks.

#### Article 59

##### **Transmission of information to other entities**

1. Notwithstanding Article 53(1) and Article 54, Member States may, by virtue of provisions laid down in national law, authorise the disclosure of certain information to other departments of their central government administrations responsible for law on the supervision of institutions, financial institutions and insurance undertakings and to inspectors acting on behalf of those departments.

However, such disclosures may be made only where necessary for reasons of prudential supervision, and prevention and resolution of failing institutions. Without prejudice to paragraph 2 of this Article, persons having access to the information shall be subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1).

<sup>(1)</sup> OJ L 331, 15.12.2010, p. 48.



In an emergency situation as referred to in Article 114(1), Member States shall allow competent authorities to disclose information which is relevant to the departments referred to in the first subparagraph of this paragraph in all Member States concerned.

2. Member States may authorise the disclosure of certain information relating to the prudential supervision of institutions to parliamentary enquiry committees in their Member State, courts of auditors in their Member State and other entities in charge of enquiries in their Member State, under the following conditions:

- (a) that the entities have a precise mandate under national law to investigate or scrutinise the actions of authorities responsible for the supervision of institutions or for laws on such supervision;
- (b) that the information is strictly necessary for fulfilling the mandate referred to in point (a);
- (c) the persons with access to the information are subject to professional secrecy requirements under national law at least equivalent to those referred to in Article 53(1);
- (d) where the information originates in another Member State that it is not disclosed without the express agreement of the competent authorities which have disclosed it and, solely for the purposes for which those authorities gave their agreement.

To the extent that the disclosure of information relating to prudential supervision involves processing of personal data, any processing by the entities referred to in the first subparagraph shall comply with the applicable national laws transposing Directive 95/46/EC.

#### Article 60

#### **Disclosure of information obtained by on-the-spot checks and inspections**

Member States shall ensure that information received under Article 52(3), Article 53(2) and Article 56 and information obtained by means of an on-the-spot check or inspection referred to in Article 52(1) and (2) shall not be disclosed under Article 59 save with the express consent of the competent authorities which disclosed the information or of the competent authorities of the Member State in which such an on-the-spot check or inspection was carried out.

#### Article 61

#### **Disclosure of information concerning clearing and settlement services**

1. Nothing in this Chapter shall prevent the competent authorities of a Member State from communicating the information

referred to in Articles 53, 54 and 55 to a clearing house or other similar body recognised under national law for the provision of clearing or settlement services for one of their national markets if they consider that it is necessary to communicate the information in order to ensure the proper functioning of those bodies in relation to defaults or potential defaults by market participants. The information received shall be subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1).

2. Member States shall, however, ensure that information received under Article 53(2) shall not be disclosed in the circumstances referred to in paragraph 1 without the express consent of the competent authorities, which have disclosed it.

#### Article 62

#### **Processing of personal data**

The processing of personal data for the purposes of this Directive shall be carried out in accordance with Directive 95/46/EC and, where relevant, with Regulation (EC) No 45/2001.

#### Section III

#### **Duty of persons responsible for the legal control of annual and consolidated accounts**

#### Article 63

#### **Duty of persons responsible for the legal control of annual and consolidated accounts**

1. Member States shall provide that any person authorised in accordance with Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts<sup>(1)</sup> and performing in an institution the tasks described in Article 51 of Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies<sup>(2)</sup>, Article 37 of Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts<sup>(3)</sup> Article 73 of Directive 2009/65/EC, or any other statutory task, shall at least have a duty to report promptly to the competent authorities any fact or decision concerning that institution of which that person has become aware while carrying out that task, which is liable to:

- (a) constitute a material breach of the laws, regulations or administrative provisions which lay down the conditions governing authorisation or which specifically govern pursuit of the activities of institutions;
- (b) affect the ongoing functioning of the institution;

<sup>(1)</sup> OJ L 157, 9.6.2006, p. 87.

<sup>(2)</sup> OJ L 222, 14.8.1978, p. 11.

<sup>(3)</sup> OJ L 193, 18.7.1983, p. 1.

- (c) lead to refusal to certify the accounts or to the expression of reservations.

Member States shall provide at least that a person referred to in the first subparagraph shall also have a duty to report any fact or decision of which that person becomes aware in the course of carrying out a task as described in the first subparagraph in an undertaking having close links resulting from a control relationship with the institution within which he is carrying out that task.

2. The disclosure in good faith to the competent authorities, by persons authorised within the meaning of Directive 2006/43/EC, of any fact or decision referred to in paragraph 1 shall not constitute a breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision and shall not involve such persons in any liability. Such disclosure shall be made simultaneously to the management body of the institution unless there are compelling reasons not to do so.

#### Section IV

### **Supervisory powers, powers to impose penalties and right of appeal**

#### *Article 64*

#### **Supervisory powers and powers to impose penalties**

1. Competent authorities shall be given all supervisory powers to intervene in the activity of institutions that are necessary for the exercise of their function, including in particular the right to withdraw an authorisation in accordance with Article 18, the powers required in accordance with Article 102 and the powers set out in Articles 104 and 105.

2. Competent authorities shall exercise their supervisory powers and their powers to impose penalties in accordance with this Directive and with national law, in any of the following ways:

- (a) directly;
- (b) in collaboration with other authorities;
- (c) under their responsibility by delegation to such authorities;
- (d) by application to the competent judicial authorities.

#### *Article 65*

#### **Administrative penalties and other administrative measures**

1. Without prejudice to the supervisory powers of competent authorities referred to in Article 64 and the right of Member

States to provide for and impose criminal penalties, Member States shall lay down rules on administrative penalties and other administrative measures in respect of breaches of national provisions transposing this Directive and of Regulation (EU) No 575/2013 and shall take all measures necessary to ensure that they are implemented. Where Member States decide not to lay down rules for administrative penalties for breaches which are subject to national criminal law they shall communicate to the Commission the relevant criminal law provisions. The administrative penalties and other administrative measures shall be effective, proportionate and dissuasive.

2. Member States shall ensure that where the obligations referred to in paragraph 1 apply to institutions, financial holding companies and mixed financial holding companies in the event of a breach of national provisions transposing this Directive or of Regulation (EU) No 575/2013, penalties may be applied, subject to the conditions laid down in national law, to the members of the management body and to other natural persons who under national law are responsible for the breach.

3. Competent authorities shall have all information gathering and investigatory powers that are necessary for the exercise of their functions. Without prejudice to other relevant provisions laid down in this Directive and in Regulation (EU) No 575/2013 those powers shall include:

- (a) the power to require the following natural or legal persons to provide all information that is necessary in order to carry out the tasks of the competent authorities, including information to be provided at recurring intervals and in specified formats for supervisory and related statistical purposes:
  - (i) institutions established in the Member State concerned;
  - (ii) financial holding companies established in the Member State concerned;
  - (iii) mixed financial holding companies established in the Member State concerned;
  - (iv) mixed-activity holding companies established in the Member State concerned;
  - (v) persons belonging to the entities referred to in points (i) to (iv);
  - (vi) third parties to whom the entities referred to in points (i) to (iv) have outsourced operational functions or activities;

(b) the power to conduct all necessary investigations of any person referred to in points (a)(i) to (vi) established or located in the Member State concerned where necessary to carry out the tasks of the competent authorities, including:

- (i) the right to require the submission of documents;
- (ii) to examine the books and records of the persons referred to in points(a)(i) to (vi) and take copies or extracts from such books and records;
- (iii) to obtain written or oral explanations from any person referred to in points (a) (i) to (vi) or their representatives or staff; and
- (iv) to interview any other person who consents to be interviewed for the purpose of collecting information relating to the subject matter of an investigation;

(c) the power, subject to other conditions set out in Union law, to conduct all necessary inspections at the business premises of the legal persons referred to in points (a)(i) to (vi) and any other undertaking included in consolidated supervision where a competent authority is the consolidating supervisor, subject to the prior notification of the competent authorities concerned. If an inspection requires authorisation by a judicial authority under national law, such authorisation shall be applied for.

#### Article 66

#### **Administrative penalties and other administrative measures for breaches of authorisation requirements and requirements for acquisitions of qualifying holdings**

1. Member States shall ensure that their laws, regulations and administrative provisions provide for administrative penalties and other administrative measures at least in respect of:

- (a) carrying out the business of taking deposits or other repayable funds from the public without being a credit institution in breach of Article 9;
- (b) commencing activities as a credit institution without obtaining authorisation in breach of Article 9;
- (c) acquiring, directly or indirectly, a qualifying holding in a credit institution or further increasing, directly or indirectly, such a qualifying holding in a credit institution as a result of which the proportion of the voting rights or of the capital held would reach or exceed the thresholds referred to in Article 22(1) or so that the credit institution would become its subsidiary, without notifying in writing the competent

authorities of the credit institution in which they are seeking to acquire or increase a qualifying holding, during the assessment period, or against the opposition of the competent authorities, in breach of Article 22(1);

(d) disposing, directly or indirectly, of a qualifying holding in a credit institution or reducing a qualifying holding so that the proportion of the voting rights or of the capital held would fall below the thresholds referred to in Article 25 or so that the credit institution would cease to be a subsidiary, without notifying in writing the competent authorities.

2. Member States shall ensure that in the cases referred to in paragraph 1, the administrative penalties and other administrative measures that can be applied include at least the following:

- (a) a public statement which identifies the natural person, institution, financial holding company or mixed financial holding company responsible and the nature of the breach;
- (b) an order requiring the natural or legal person responsible to cease the conduct and to desist from a repetition of that conduct;
- (c) in the case of a legal person, administrative pecuniary penalties of up to 10 % of the total annual net turnover including the gross income consisting of interest receivable and similar income, income from shares and other variable or fixed-yield securities, and commissions or fees receivable in accordance with Article 316 of Regulation (EU) No 575/2013 of the undertaking in the preceding business year;
- (d) in the case of a natural person, administrative pecuniary penalties of up to EUR 5 000 000, or in the Member States whose currency is not the euro, the corresponding value in the national currency on 17 July 2013;
- (e) administrative pecuniary penalties of up to twice the amount of the benefit derived from the breach where that benefit can be determined;
- (f) suspension of the voting rights of the shareholder or shareholders held responsible for the breaches referred to in paragraph 1.

Where the undertaking referred to in point (c) of the first subparagraph is a subsidiary of a parent undertaking, the relevant gross income shall be the gross income resulting from the consolidated account of the ultimate parent undertaking in the preceding business year.

## Article 67

**Other provisions**

1. This Article shall apply at least in any of the following circumstances:

- (a) an institution has obtained an authorisation through false statements or any other irregular means;
- (b) an institution, on becoming aware of any acquisitions or disposals of holdings in their capital that cause holdings to exceed or fall below one of the thresholds referred to in Article 22(1) or Article 25, fails to inform the competent authorities of those acquisitions or disposals in breach of the first subparagraph of Article 26(1);
- (c) an institution listed on a regulated market as referred to in the list to be published by ESMA in accordance with Article 47 of Directive 2004/39/EC does not, at least annually, inform the competent authorities of the names of shareholders and members possessing qualifying holdings and the sizes of such holdings in breach of the second subparagraph of Article 26(1) of this Directive;
- (d) an institution fails to have in place governance arrangements required by the competent authorities in accordance with the national provisions transposing Article 74;
- (e) an institution fails to report information or provides incomplete or inaccurate information on compliance with the obligation to meet own funds requirements set out in Article 92 of Regulation (EU) No 575/2013 to the competent authorities in breach of Article 99(1) of that Regulation;
- (f) an institution fails to report or provides incomplete or inaccurate information to the competent authorities in relation to the data referred to in Article 101 of Regulation (EU) No 575/2013;
- (g) an institution fails to report information or provides incomplete or inaccurate information about a large exposure to the competent authorities in breach of Article 394(1) of Regulation (EU) No 575/2013;
- (h) an institution fails to report information or provides incomplete or inaccurate information on liquidity to the competent authorities in breach of Article 415(1) and (2) of Regulation (EU) No 575/2013;
- (i) an institution fails to report information or provides incomplete or inaccurate information on the leverage ratio to the competent authorities in breach of Article 430(1) of Regulation (EU) No 575/2013;

- (j) an institution repeatedly or persistently fails to hold liquid assets in breach of Article 412 of Regulation (EU) No 575/2013;
- (k) an institution incurs an exposure in excess of the limits set out in Article 395 of Regulation (EU) No 575/2013;
- (l) an institution is exposed to the credit risk of a securitisation position without satisfying the conditions set out in Article 405 of Regulation (EU) No 575/2013;
- (m) an institution fails to disclose information or provides incomplete or inaccurate information in breach of Article 431(1), (2) and (3) or Article 451(1) of Regulation (EU) No 575/2013;
- (n) an institution makes payments to holders of instruments included in the own funds of the institution in breach of Article 141 of this Directive or in cases where Articles 28, 51 or 63 of Regulation (EU) No 575/2013 prohibit such payments to holders of instruments included in own funds;
- (o) an institution is found liable for a serious breach of the national provisions adopted pursuant to Directive 2005/60/EC;
- (p) an institution allows one or more persons not complying with Article 91 to become or remain a member of the management body.

2. Member States shall ensure that in the cases referred to in paragraph 1, the administrative penalties and other administrative measures that can be applied include at least the following:

- (a) a public statement which identifies the natural person, institution, financial holding company or mixed financial holding company responsible and the nature of the breach;
- (b) an order requiring the natural or legal person responsible to cease the conduct and to desist from a repetition of that conduct;
- (c) in the case of an institution, withdrawal of the authorisation of the institution in accordance with Article 18;
- (d) subject to Article 65(2), a temporary ban against a member of the institution's management body or any other natural person, who is held responsible, from exercising functions in institutions;

- (e) in the case of a legal person, administrative pecuniary penalties of up to 10 % of the total annual net turnover including the gross income consisting of interest receivable and similar income, income from shares and other variable or fixed-yield securities, and commissions or fees receivable in accordance with Article 316 of Regulation (EU) No 575/2013 of the undertaking in the preceding business year;
- (f) in the case of a natural person, administrative pecuniary penalties of up to EUR 5 000 000, or in the Member States whose currency is not the euro, the corresponding value in the national currency on 17 July 2013;
- (g) administrative pecuniary penalties of up to twice the amount of the profits gained or losses avoided because of the breach where those can be determined.

Where an undertaking referred to in point (e) of the first subparagraph is a subsidiary of a parent undertaking, the relevant gross income shall be the gross income resulting from the consolidated account of the ultimate parent undertaking in the preceding business year.

#### Article 68

##### Publication of administrative penalties

1. Member States shall ensure that the competent authorities publish on their official website at least any administrative penalties against which there is no appeal and which are imposed for breach of the national provisions transposing this Directive or of Regulation (EU) No 575/2013, including information on the type and nature of the breach and the identity of the natural or legal person on whom the penalty is imposed, without undue delay after that person is informed of those penalties.

Where Member States permit publication of penalties against which there is an appeal, competent authorities shall, without undue delay, also publish on their official website information on the appeal status and outcome thereof.

2. Competent authorities shall publish the penalties on an anonymous basis, in a manner in accordance with national law, in any of the following circumstances:

- (a) where the penalty is imposed on a natural person and, following an obligatory prior assessment, publication of personal data is found to be disproportionate;
- (b) where publication would jeopardise the stability of financial markets or an ongoing criminal investigation;

- (c) where publication would cause, insofar as it can be determined, disproportionate damage to the institutions or natural persons involved.

Alternatively, where the circumstances referred to in the first subparagraph are likely to cease within a reasonable period of time, publication under paragraph 1 may be postponed for such a period of time.

3. Competent authorities shall ensure that information published under paragraphs 1 or 2 remains on their official website at least five years. Personal data shall be retained on the official website of the competent authority only for the period necessary, in accordance with the applicable data protection rules.

4. By 18 July 2015 EBA shall submit a report to the Commission on the publication of penalties by Member States on an anonymous basis as provided for under paragraph 2, in particular where there have been significant divergences between Member States in this respect. In addition, EBA shall submit a report to the Commission on any significant divergences in the duration of publication of penalties under national law.

#### Article 69

##### Exchange of information on penalties and maintenance of a central database by EBA

1. Subject to the professional secrecy requirements referred to in Article 53(1), the competent authorities shall inform EBA of all administrative penalties, including all permanent prohibitions, imposed under Articles 65, 66 and 67 including any appeal in relation thereto and the outcome thereof. EBA shall maintain a central database of administrative penalties communicated to it solely for the purposes of exchanging information between competent authorities. That database shall be accessible to competent authorities only and it shall be updated on the basis of the information provided by competent authorities.

2. Where a competent authority assesses good repute for the purposes of Article 13(1), Article 16(3), Article 91(1) and Article 121, it shall consult the EBA database of administrative penalties. In the event of a change of status or a successful appeal, EBA shall delete or update relevant entries in the database on request by the competent authorities.

3. The competent authorities shall check, in accordance with national law, the existence of a relevant conviction in the criminal record of the person concerned. For those purposes, information shall be exchanged in accordance with Decision 2009/316/JHA and Framework Decision 2009/315/JHA as implemented in national law.



4. EBA shall maintain a website with links to each competent authority's publication of administrative penalties under Article 68 and shall show the time period for which each Member State publishes administrative penalties.

#### Article 70

##### **Effective application of penalties and exercise of powers to impose penalties by competent authorities**

Member States shall ensure that when determining the type of administrative penalties or other administrative measures and the level of administrative pecuniary penalties, the competent authorities shall take into account all relevant circumstances, including, where appropriate:

- (a) the gravity and the duration of the breach;
- (b) the degree of responsibility of the natural or legal person responsible for the breach;
- (c) the financial strength of the natural or legal person responsible for the breach, as indicated, for example, by the total turnover of a legal person or the annual income of a natural person;
- (d) the importance of profits gained or losses avoided by the natural or legal person responsible for the breach, insofar as they can be determined;
- (e) the losses for third parties caused by the breach, insofar as they can be determined;
- (f) the level of cooperation of the natural or legal person responsible for the breach with the competent authority;
- (g) previous breaches by the natural or legal person responsible for the breach;
- (h) any potential systemic consequences of the breach.

#### Article 71

##### **Reporting of breaches**

1. Member States shall ensure that competent authorities establish effective and reliable mechanisms to encourage reporting of potential or actual breaches of national provisions transposing this Directive and of Regulation (EU) No 575/2013 to competent authorities.

2. The mechanisms referred to in paragraph 1 shall include at least:

- (a) specific procedures for the receipt of reports on breaches and their follow-up;
- (b) appropriate protection for employees of institutions who report breaches committed within the institution against retaliation, discrimination or other types of unfair treatment at a minimum;
- (c) protection of personal data concerning both the person who reports the breaches and the natural person who is allegedly responsible for a breach, in accordance with Directive 95/46/EC;
- (d) clear rules that ensure that confidentiality is guaranteed in all cases in relation to the person who reports the breaches committed within the institution, unless disclosure is required by national law in the context of further investigations or subsequent judicial proceedings.

3. Member States shall require institutions to have in place appropriate procedures for their employees to report breaches internally through a specific, independent and autonomous channel.

Such a channel may also be provided through arrangements provided for by social partners. The same protection as referred to in points (b), (c) and (d) of paragraph 2 shall apply.

#### Article 72

##### **Right of appeal**

Member States shall ensure that decisions and measures taken pursuant to laws, regulations and administrative provisions adopted in accordance with this Directive or to Regulation (EU) No 575/2013 are subject to a right of appeal. Member States shall also ensure that failure to take a decision within six months of submission of an application for authorisation which contains all the information required under the national provisions transposing this Directive, is subject to a right of appeal.

#### CHAPTER 2

##### **Review Processes**

##### Section I

##### **Internal capital adequacy assessment process**

#### Article 73

##### **Internal Capital**

Institutions shall have in place sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed.

Those strategies and processes shall be subject to regular internal review to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the activities of the institution concerned.

## Section II

### Arrangements, processes and mechanisms of institutions

#### Sub-Section 1

#### General principles

##### Article 74

#### Internal governance and recovery and resolution plans

1. Institutions shall have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management.

2. The arrangements, processes and mechanisms referred to in paragraph 1 shall be comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the business model and the institution's activities. The technical criteria established in Articles 76 to 95 shall be taken into account.

3. EBA shall issue guidelines on the arrangements, processes and mechanisms referred to in paragraph 1, in accordance with paragraph 2.

4. Competent authorities shall ensure that recovery plans for the restoration of an institution's financial situation following a significant deterioration, and resolution plans are put in place. In accordance with the principle of proportionality, the requirements for an institution to draw up, maintain and update recovery plans and for the resolution authority, after consulting the competent authority, to prepare resolution plans, may be reduced if, after consulting the national macro-prudential authority, competent authorities consider that the failure of a specific institution due, *inter alia*, to its size, to its business model, to its interconnectedness to other institutions, or to the financial system in general, will not have a negative effect on financial markets, on other institutions or on funding conditions.

Institutions shall cooperate closely with resolution authorities and shall provide them with all information necessary for the preparation and drafting of viable resolution plans setting out options for the orderly resolution of the institutions in the case of failure, in accordance with the principle of proportionality.

In accordance with Article 25 of Regulation (EU) No 1093/2010, EBA shall be entitled to participate in and contribute to the development and coordination of effective and consistent recovery and resolution plans.

In that regard EBA shall be informed of, and shall be entitled to participate in, meetings relating to the development and coordination of recovery and resolution plans. Where any such meetings or activities take place, EBA shall be fully informed in advance of the organisation of such meetings, of the main issues to be discussed and of the activities to be considered.

##### Article 75

#### Oversight of remuneration policies

1. Competent authorities shall collect the information disclosed in accordance with the criteria for disclosure established in points (g), (h) and (i) of Article 450(1) of Regulation (EU) No 575/2013 and shall use it to benchmark remuneration trends and practices. The competent authorities shall provide EBA with that information.

2. EBA shall issue guidelines on sound remuneration policies which comply with the principles set out in Articles 92 to 95. The guidelines shall take into account the principles on sound remuneration policies set out in Commission Recommendation 2009/384/EC of 30 April 2009 on remuneration policies in the financial services sector <sup>(1)</sup>.

ESMA shall cooperate closely with EBA to develop guidelines on remuneration policies for categories of staff involved in the provision of investment services and activities within the meaning of point 2 of Article 4(1) of Directive 2004/39/EC.

EBA shall use the information received from the competent authorities in accordance with paragraph 1 to benchmark remuneration trends and practices at Union level.

3. Competent authorities shall collect information on the number of natural persons per institution that are remunerated EUR 1 million or more per financial year, in pay brackets of EUR 1 million, including their job responsibilities, the business area involved and the main elements of salary, bonus, long-term award and pension contribution. That information shall be forwarded to EBA, which shall publish it on an aggregate home Member State basis in a common reporting format. EBA may elaborate guidelines to facilitate the implementation of this paragraph and ensure the consistency of the information collected.

<sup>(1)</sup> OJ L 120, 15.5.2009, p. 22.

## Sub-Section 2

**Technical criteria concerning the organisation and treatment of risks**

## Article 76

**Treatment of risks**

1. Member States shall ensure that the management body approves and periodically reviews the strategies and policies for taking up, managing, monitoring and mitigating the risks the institution is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

2. Member States shall ensure that the management body devotes sufficient time to consideration of risk issues. The management body shall be actively involved in and ensure that adequate resources are allocated to the management of all material risks addressed in this Directive and in Regulation (EU) No 575/2013 as well as in the valuation of assets, the use of external credit ratings and internal models relating to those risks. The institution shall establish reporting lines to the management body that cover all material risks and risk management policies and changes thereof.

3. Member States shall ensure that institutions that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities establish a risk committee composed of members of the management body who do not perform any executive function in the institution concerned. Members of the risk committee shall have appropriate knowledge, skills and expertise to fully understand and monitor the risk strategy and the risk appetite of the institution.

The risk committee shall advise the management body on the institution's overall current and future risk appetite and strategy and assist the management body in overseeing the implementation of that strategy by senior management. The management body shall retain overall responsibility for risks.

The risk committee shall review whether prices of liabilities and assets offered to clients take fully into account the institution's business model and risk strategy. Where prices do not properly reflect risks in accordance with the business model and risk strategy, the risk committee shall present a remedy plan to the management body.

Competent authorities may allow an institution which is not considered significant as referred to in the first subparagraph to combine the risk committee with the audit committee as referred to in Article 41 of Directive 2006/43/EC. Members of the combined committee shall have the knowledge, skills and expertise required for the risk committee and for the audit committee.

4. Member States shall ensure that the management body in its supervisory function and, where a risk committee has been established, the risk committee have adequate access to information on the risk situation of the institution and, if necessary and appropriate, to the risk management function and to external expert advice.

The management body in its supervisory function and, where one has been established, the risk committee shall determine the nature, the amount, the format, and the frequency of the information on risk which it is to receive. In order to assist in the establishment of sound remuneration policies and practices, the risk committee shall, without prejudice to the tasks of the remuneration committee, examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings.

5. Member States shall, in accordance with the proportionality requirement laid down in Article 7(2) of Commission Directive 2006/73/EC<sup>(1)</sup>, ensure that institutions have a risk management function independent from the operational functions and which shall have sufficient authority, stature, resources and access to the management body.

Member States shall ensure that the risk management function ensures that all material risks are identified, measured and properly reported. They shall ensure that the risk management function is actively involved in elaborating the institution's risk strategy and in all material risk management decisions and that it can deliver a complete view of the whole range of risks of the institution.

Where necessary, Member States shall ensure that the risk management function can report directly to the management body in its supervisory function, independent from senior management, and can raise concerns and warn that body, where appropriate, where specific risk developments affect or may affect the institution, without prejudice to the responsibilities of the management body in its supervisory and/or managerial functions pursuant to this Directive and Regulation (EU) No 575/2013.

The head of the risk management function shall be an independent senior manager with distinct responsibility for the risk management function. Where the nature, scale and complexity of the activities of the institution do not justify a specially appointed person, another senior person within the institution may fulfil that function, provided there is no conflict of interest.

<sup>(1)</sup> Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 241, 2.9.2006, p. 26).

The head of the risk management function shall not be removed without prior approval of the management body in its supervisory function and shall be able to have direct access to the management body in its supervisory function where necessary.

The application of this Directive shall be without prejudice to the application of Directive 2006/73/EC to investment firms.

#### Article 77

##### **Internal Approaches for calculating own funds requirements**

1. Competent authorities shall encourage institutions that are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities to develop internal credit risk assessment capacity and to increase use of the internal ratings based approach for calculating own funds requirements for credit risk where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties. This Article shall be without prejudice to the fulfilment of criteria laid down in Part Three, Title I, Chapter 3, Section 1 of Regulation (EU) No 575/2013.

2. Competent authorities shall, taking into account the nature, scale and complexity of institutions' activities, monitor that they do not solely or mechanistically rely on external credit ratings for assessing the creditworthiness of an entity or financial instrument.

3. Competent authorities shall encourage institutions, taking into account their size, internal organisation and the nature, scale and complexity of their activities, to develop internal specific risk assessment capacity and to increase use of internal models for calculating own funds requirements for specific risk of debt instruments in the trading book, together with internal models to calculate own funds requirements for default and migration risk where their exposures to specific risk are material in absolute terms and where they have a large number of material positions in debt instruments of different issuers.

This Article shall be without prejudice to the fulfilment of the criteria laid down in Part Three, Title IV, Chapter 5, Sections 1 to 5, of Regulation (EU) No 575/2013.

4. EBA shall develop draft regulatory technical standards to further define the notion 'exposures to specific risk which are material in absolute terms' referred to in the first subparagraph of paragraph 3 and the thresholds for large numbers of material counterparties and positions in debt instruments of different issuers.

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

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

#### Article 78

##### **Supervisory benchmarking of internal approaches for calculating own funds requirements**

1. Competent authorities shall ensure that institutions permitted to use internal approaches for the calculation of risk weighted exposure amounts or own fund requirements except for operational risk report the results of the calculations of their internal approaches for their exposures or positions that are included in the benchmark portfolios. Institutions shall submit the results of their calculations, together with an explanation of the methodologies used to produce them, to the competent authorities at an appropriate frequency, and at least annually.

2. Competent authorities shall ensure that institutions submit the results of the calculations referred to in paragraph 1 in accordance with the template developed by EBA in accordance with paragraph 8 to the competent authorities and to EBA. Where competent authorities choose to develop specific portfolios, they shall do so in consultation with EBA and ensure that institutions report the results of the calculations separately from the results of the calculations for EBA portfolios.

3. Competent authorities shall, on the basis of the information submitted by institutions in accordance with paragraph 1, monitor the range of risk weighted exposure amounts or own funds requirements, as applicable, except for operational risk, for the exposures or transactions in the benchmark portfolio resulting from the internal approaches of those institutions. At least annually, competent authorities shall make an assessment of the quality of those approaches paying particular attention to:

- (a) those approaches that exhibit significant differences in own fund requirements for the same exposure;
- (b) approaches where there is particularly high or low diversity, and also where there is a significant and systematic under-estimation of own funds requirements.

EBA shall produce a report to assist the competent authorities in the assessment of the quality of the internal approaches based on the information referred to in paragraph 2.

4. Where particular institutions diverge significantly from the majority of their peers or where there is little commonality in approach leading to a wide variance of results, competent authorities shall investigate the reasons therefor and, if it can be clearly identified that an institution's approach leads to an underestimation of own funds requirements which is not attributable to differences in the underlying risks of the exposures or positions, shall take corrective action.

5. The competent authorities shall ensure that their decisions on the appropriateness of corrective actions as referred to in paragraph 4 comply with the principle that such actions must maintain the objectives of an internal approach and therefore do not:

- (a) lead to standardisation or preferred methods;
- (b) create wrong incentives; or
- (c) cause herd behaviour.

6. EBA may issue guidelines and recommendations in accordance with Article 16 of Regulation (EU) No 1093/2010 where it considers them necessary on the basis of the information and assessments referred to in paragraphs 2 and 3 of this Article in order to improve supervisory practices or practices of institutions with regard to internal approaches.

7. EBA shall develop draft regulatory technical standards to specify:

- (a) the procedures for sharing assessments made in accordance with paragraph 3 between the competent authorities and with EBA;
- (b) the standards for the assessment made by competent authorities referred to in paragraph 3.

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

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

8. EBA shall develop draft implementing technical standards to specify:

- (a) the template, the definitions and the IT-solutions to be applied in the Union for the reporting referred to in paragraph 2;

- (b) the benchmark portfolio or portfolios referred to in paragraph 1.

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 Article 15 of Regulation (EU) No 1093/2010.

9. The Commission shall, by 1 April 2015 and after consulting EBA, submit a report to the European Parliament and to the Council on the functioning of the benchmarking of internal models including the scope of the model. Where appropriate, the report shall be followed by a legislative proposal.

#### Article 79

#### **Credit and counterparty risk**

Competent authorities shall ensure that:

- (a) credit-granting is based on sound and well-defined criteria and that the process for approving, amending, renewing, and re-financing credits is clearly established;
- (b) institutions have internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level. In particular, internal methodologies shall not rely solely or mechanically on external credit ratings. Where own funds requirements are based on a rating by an External Credit Assessment Institution (ECAI) or based on the fact that an exposure is unrated, this shall not exempt institutions from additionally considering other relevant information for assessing their allocation of internal capital;
- (c) the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures of institutions, including for identifying and managing problem credits and for making adequate value adjustments and provisions, is operated through effective systems;
- (d) diversification of credit portfolios is adequate given an institution's target markets and overall credit strategy.

#### Article 80

#### **Residual risk**

Competent authorities shall ensure that the risk that recognised credit risk mitigation techniques used by institutions prove less effective than expected is addressed and controlled including by means of written policies and procedures.



*Article 81***Concentration risk**

Competent authorities shall ensure that the concentration risk arising from exposures to each counterparty, including central counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity, the application of credit risk mitigation techniques, and including in particular risks associated with large indirect credit exposures such as a single collateral issuer, is addressed and controlled including by means of written policies and procedures.

*Article 82***Securitisation risk**

1. Competent authorities shall ensure that the risks arising from securitisation transactions in relation to which the credit institutions are investor, originator or sponsor, including reputational risks, such as arise in relation to complex structures or products, are evaluated and addressed through appropriate policies and procedures, to ensure that the economic substance of the transaction is fully reflected in the risk assessment and management decisions.

2. Competent authorities shall ensure that liquidity plans to address the implications of both scheduled and early amortisation exist at institutions which are originators of revolving securitisation transactions involving early amortisation provisions.

*Article 83***Market risk**

1. Competent authorities shall ensure that policies and processes for the identification, measurement and management of all material sources and effects of market risks are implemented.

2. Where the short position falls due before the long position, competent authorities shall ensure that institutions also take measures against the risk of a shortage of liquidity.

3. The internal capital shall be adequate for material market risks that are not subject to an own funds requirement.

Institutions, which have, in calculating own funds requirements for position risk in accordance with Part Three, Title IV, Chapter 2, of Regulation (EU) No 575/2013, netted off their positions in one or more of the equities constituting a stock-index against one or more positions in the stock-index future or other stock-index product shall have adequate internal capital to cover the basis risk of loss caused by the future's or other product's value not moving fully in line with that of its constituent equities. Institutions shall also have such adequate internal capital where they hold opposite positions in stock-index futures which are not identical in respect of either their maturity or their composition or both.

Where using the treatment in Article 345 of Regulation (EU) No 575/2013, institutions shall ensure that they hold sufficient internal capital against the risk of loss which exists between the time of the initial commitment and the following working day.

*Article 84***Interest risk arising from non-trading book activities**

Competent authorities shall ensure that institutions implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect an institution's non-trading activities.

*Article 85***Operational risk**

1. Competent authorities shall ensure that institutions implement policies and processes to evaluate and manage the exposure to operational risk, including model risk, and to cover low-frequency high-severity events. Institutions shall articulate what constitutes operational risk for the purposes of those policies and procedures.

2. Competent authorities shall ensure that contingency and business continuity plans are in place to ensure an institution's ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

*Article 86***Liquidity risk**

1. Competent authorities shall ensure that institutions have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intraday, so as to ensure that institutions maintain adequate levels of liquidity buffers. Those strategies, policies, processes and systems shall be tailored to business lines, currencies, branches and legal entities and shall include adequate allocation mechanisms of liquidity costs, benefits and risks.

2. The strategies, policies, processes and systems referred to in paragraph 1 shall be proportionate to the complexity, risk profile, scope of operation of the institutions and risk tolerance set by the management body and reflect the institution's importance in each Member State in which it carries out business. Institutions shall communicate risk tolerance to all relevant business lines.

3. Competent authorities shall ensure that institutions, taking into account the nature, scale and complexity of their activities, have liquidity risk profiles that are consistent with and, not in excess of, those required for a well-functioning and robust system.

Competent authorities shall monitor developments in relation to liquidity risk profiles, for example product design and volumes, risk management, funding policies and funding concentrations.

Competent authorities shall take effective action where developments referred to in the second subparagraph may lead to individual institution or systemic instability.

Competent authorities shall inform EBA about any actions carried out pursuant to the third subparagraph.

EBA shall make recommendations where appropriate in accordance with Regulation (EU) No 1093/2010.

4. Competent authorities shall ensure that institutions develop methodologies for the identification, measurement, management and monitoring of funding positions. Those methodologies shall include the current and projected material cash-flows in and arising from assets, liabilities, off-balance-sheet items, including contingent liabilities and the possible impact of reputational risk.

5. Competent authorities shall ensure that institutions distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations. They shall also ensure that institutions take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account and their eligibility and shall monitor how assets can be mobilised in a timely manner.

6. Competent authorities shall ensure that institutions also have regard to existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst entities, both within and outside the European Economic Area.

7. Competent authorities shall ensure that institutions consider different liquidity risk mitigation tools, including a system of limits and liquidity buffers in order to be able to withstand a range of different stress events and an adequately diversified funding structure and access to funding sources. Those arrangements shall be reviewed regularly.

8. Competent authorities shall ensure that institutions consider alternative scenarios on liquidity positions and on risk mitigants and review the assumptions underlying decisions concerning the funding position at least annually. For those purposes, alternative scenarios shall address, in

particular, off-balance sheet items and other contingent liabilities, including those of Securitisation Special Purpose Entities (SSPE) or other special purpose entities, as referred to in Regulation (EU) No 575/2013, in relation to which the institution acts as sponsor or provides material liquidity support.

9. Competent authorities shall ensure that institutions consider the potential impact of institution-specific, market-wide and combined alternative scenarios. Different time periods and varying degrees of stress conditions shall be considered.

10. Competent authorities shall ensure that institutions adjust their strategies, internal policies and limits on liquidity risk and develop effective contingency plans, taking into account the outcome of the alternative scenarios referred to in paragraph 8.

11. Competent authorities shall ensure that institutions have in place liquidity recovery plans setting out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls, including in relation to branches established in another Member State. Competent authorities shall ensure that those plans are tested by the institutions at least annually, updated on the basis of the outcome of the alternative scenarios set out in paragraph 8, reported to and approved by senior management, so that internal policies and processes can be adjusted accordingly. Institutions shall take the necessary operational steps in advance to ensure that liquidity recovery plans can be implemented immediately. For credit institutions, such operational steps shall include holding collateral immediately available for central bank funding. This includes holding collateral where necessary in the currency of another Member State, or the currency of a third country to which the credit institution has exposures, and where operationally necessary within the territory of a host Member State or of a third country to whose currency it is exposed.

#### Article 87

#### **Risk of excessive leverage**

1. Competent authorities shall ensure that institutions have policies and processes in place for the identification, management and monitoring of the risk of excessive leverage. Indicators for the risk of excessive leverage shall include the leverage ratio determined in accordance with Article 429 of Regulation (EU) No 575/2013 and mismatches between assets and obligations.

2. Competent authorities shall ensure that institutions address the risk of excessive leverage in a precautionary manner by taking due account of potential increases in the risk of excessive leverage caused by reductions of the institution's own funds through expected or realised losses, depending on the applicable accounting rules. To that end, institutions shall be able to withstand a range of different stress events with respect to the risk of excessive leverage.

## Sub-Section 3

**Governance**

## Article 88

**Governance arrangements**

1. Member States shall ensure that the management body defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organisation and the prevention of conflicts of interest.

Those arrangements shall comply with the following principles:

- (a) the management body must have the overall responsibility for the institution and approve and oversee the implementation of the institution's strategic objectives, risk strategy and internal governance;
- (b) the management body must ensure the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards;
- (c) the management body must oversee the process of disclosure and communications;
- (d) the management body must be responsible for providing effective oversight of senior management;
- (e) the chairman of the management body in its supervisory function of an institution must not exercise simultaneously the functions of a chief executive officer within the same institution, unless justified by the institution and authorised by competent authorities.

Member States shall ensure that the management body monitors and periodically assesses the effectiveness of the institution's governance arrangements and takes appropriate steps to address any deficiencies.

2. Member States shall ensure that institutions which are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities establish a nomination committee composed of members of the management body who do not perform any executive function in the institution concerned.

The nomination committee shall:

- (a) identify and recommend, for the approval of the management body or for approval of the general meeting, candidates to fill management body vacancies, evaluate the

balance of knowledge, skills, diversity and experience of the management body and prepare a description of the roles and capabilities for a particular appointment, and assess the time commitment expected.

Furthermore, the nomination committee shall decide on a target for the representation of the underrepresented gender in the management body and prepare a policy on how to increase the number of the underrepresented gender in the management body in order to meet that target. The target, policy and its implementation shall be made public in accordance with Article 435(2)(c) of Regulation (EU) No 575/2013;

- (b) periodically, and at least annually, assess the structure, size, composition and performance of the management body and make recommendations to the management body with regard to any changes;
- (c) periodically, and at least annually, assess the knowledge, skills and experience of individual members of the management body and of the management body collectively, and report to the management body accordingly;
- (d) periodically review the policy of the management body for selection and appointment of senior management and make recommendations to the management body.

In performing its duties, the nomination committee shall, to the extent possible and on an ongoing basis, take account of the need to ensure that the management body's decision making is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interests of the institution as a whole.

The nomination committee shall be able to use any forms of resources that it considers to be appropriate, including external advice, and shall receive appropriate funding to that effect.

Where, under national law, the management body does not have any competence in the process of selection and appointment of any of its members, this paragraph shall not apply.

## Article 89

**Country-by-country reporting**

1. From 1 January 2015 Member States shall require each institution to disclose annually, specifying, by Member State and by third country in which it has an establishment, the following information on a consolidated basis for the financial year:

- (a) name(s), nature of activities and geographical location;

(b) turnover;

(c) number of employees on a full time equivalent basis;

(d) profit or loss before tax;

(e) tax on profit or loss;

(f) public subsidies received.

2. Notwithstanding paragraph 1, Member States shall require institutions to disclose the information referred to in paragraph 1(a), (b) and (c) for the first time on 1 July 2014.

3. By 1 July 2014, all global systemically important institutions authorised within the Union, as identified internationally, shall submit to the Commission the information referred to in paragraph 1(d), (e) and (f) on a confidential basis. The Commission, after consulting EBA, EIOPA and ESMA, as appropriate, shall conduct a general assessment as regards potential negative economic consequences of the public disclosure of such information, including the impact on competitiveness, investment and credit availability and the stability of the financial system. The Commission shall submit its report to the European Parliament and to the Council by 31 December 2014.

In the event that the Commission report identifies significant negative effects, the Commission shall consider making an appropriate legislative proposal for an amendment of the disclosure obligations set out in paragraph 1 and may, in accordance with point (h) of Article 145, decide to defer those obligations. The Commission shall review the necessity to extend deferral annually.

4. The information referred to in paragraph 1 shall be audited in accordance with Directive 2006/43/EC and shall be published, where possible, as an annex to the annual financial statements or, where applicable, to the consolidated financial statements of the institution concerned.

5. To the extent that future Union legislative acts for disclosure obligations go beyond those laid down in this Article, this Article shall cease to apply and shall be deleted accordingly.

#### Article 90

##### Public disclosure of return on assets

Institutions shall disclose in their annual report among the key indicators their return on assets, calculated as their net profit divided by their total balance sheet.

#### Article 91

##### Management body

1. Members of the management body shall at all times be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties. The overall composition of the management body shall reflect an adequately broad range of experiences. Members of the management body shall, in particular, fulfil the requirements set out in paragraphs 2 to 8.

2. All members of the management body shall commit sufficient time to perform their functions in the institution.

3. The number of directorships which may be held by a member of the management body at the same time shall take into account individual circumstances and the nature, scale and complexity of the institution's activities. Unless representing the Member State, members of the management body of an institution that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities shall, from 1 July 2014, not hold more than one of the following combinations of directorships at the same time:

(a) one executive directorship with two non-executive directorships;

(b) four non-executive directorships.

4. For the purposes of paragraph 3, the following shall count as a single directorship:

(a) executive or non-executive directorships held within the same group;

(b) executive or non-executive directorships held within:

(i) institutions which are members of the same institutional protection scheme provided that the conditions set out in Article 113(7) of Regulation (EU) No 575/2013 are fulfilled; or

(ii) undertakings (including non-financial entities) in which the institution holds a qualifying holding.

5. Directorships in organisations which do not pursue predominantly commercial objectives shall not count for the purposes of paragraph 3.

6. Competent authorities may authorise members of the management body to hold one additional non-executive directorship. Competent authorities shall regularly inform EBA of such authorisations.

7. The management body shall possess adequate collective knowledge, skills and experience to be able to understand the institution's activities, including the main risks.

8. Each member of the management body shall act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making.

9. Institutions shall devote adequate human and financial resources to the induction and training of members of the management body.

10. Member States or competent authorities shall require institutions and their respective nomination committees to engage a broad set of qualities and competences when recruiting members to the management body and for that purpose to put in place a policy promoting diversity on the management body.

11. Competent authorities shall collect the information disclosed in accordance with Article 435(2)(c) of Regulation (EU) No 575/2013 and shall use it to benchmark diversity practices. The competent authorities shall provide EBA with that information. EBA shall use that information to benchmark diversity practices at Union level.

12. EBA shall issue guidelines on the following:

- (a) the notion of sufficient time commitment of a member of the management body to perform his functions, in relation to the individual circumstances and the nature, scale and complexity of activities of the institution;
- (b) the notion of adequate collective knowledge, skills and experience of the management body as referred to in paragraph 7;
- (c) the notions of honesty, integrity and independence of mind of a member of the management body as referred to in paragraph 8;
- (d) the notion of adequate human and financial resources devoted to the induction and training of members of the management body as referred to in paragraph 9;
- (e) the notion of diversity to be taken into account for the selection of members of the management body as referred to in paragraph 10.

EBA shall issue those guidelines by 31 December 2015.

13. This Article shall be without prejudice to provisions on the representation of employees in the management body as provided for by national law.

#### Article 92

##### Remuneration policies

1. The application of paragraph 2 of this Article and of Articles 93, 94 and 95 shall be ensured by competent authorities for institutions at group, parent company and subsidiary levels, including those established in offshore financial centres.

2. Competent authorities shall ensure that, when establishing and applying the total remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile, institutions comply with the following principles in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities:

- (a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the institution;
- (b) the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the institution, and incorporates measures to avoid conflicts of interest;
- (c) the institution's management body in its supervisory function adopts and periodically reviews the general principles of the remuneration policy and is responsible for overseeing its implementation;
- (d) the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;
- (e) staff engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;
- (f) the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee referred to in Article 95 or, if such a committee has not been established, by the management body in its supervisory function;



(g) the remuneration policy, taking into account national criteria on wage setting, makes a clear distinction between criteria for setting:

- (i) basic fixed remuneration, which should primarily reflect relevant professional experience and organisational responsibility as set out in an employee's job description as part of the terms of employment; and
- (ii) variable remuneration which should reflect a sustainable and risk adjusted performance as well as performance in excess of that required to fulfil the employee's job description as part of the terms of employment.

#### Article 93

##### **Institutions that benefit from government intervention**

In the case of institutions that benefit from exceptional government intervention, the following principles shall apply in addition to those set out in Article 92(2):

- (a) variable remuneration is strictly limited as a percentage of net revenue where it is inconsistent with the maintenance of a sound capital base and timely exit from government support;
- (b) the relevant competent authorities require institutions to restructure remuneration in a manner aligned with sound risk management and long-term growth, including, where appropriate, establishing limits to the remuneration of the members of the management body of the institution;
- (c) no variable remuneration is paid to members of the management body of the institution unless justified.

#### Article 94

##### **Variable elements of remuneration**

1. For variable elements of remuneration, the following principles shall apply in addition to, and under the same conditions as, those set out in Article 92(2):

- (a) where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the institution and when assessing individual performance, financial and non-financial criteria are taken into account;
- (b) the assessment of the performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual

payment of performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the credit institution and its business risks;

- (c) the total variable remuneration does not limit the ability of the institution to strengthen its capital base;
- (d) guaranteed variable remuneration is not consistent with sound risk management or the pay-for-performance principle and shall not be a part of prospective remuneration plans;
- (e) guaranteed variable remuneration is exceptional, occurs only when hiring new staff and where the institution has a sound and strong capital base and is limited to the first year of employment;
- (f) fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component;
- (g) institutions shall set the appropriate ratios between the fixed and the variable component of the total remuneration, whereby the following principles shall apply:
  - (i) the variable component shall not exceed 100 % of the fixed component of the total remuneration for each individual. Member States may set a lower maximum percentage;
  - (ii) Member States may allow shareholders or owners or members of the institution to approve a higher maximum level of the ratio between the fixed and variable components of remuneration provided the overall level of the variable component shall not exceed 200 % of the fixed component of the total remuneration for each individual. Member States may set a lower maximum percentage.

Any approval of a higher ratio in accordance with the first subparagraph of this point shall be carried out in accordance with the following procedure:

- the shareholders or owners or members of the institution shall act upon a detailed recommendation by the institution giving the reasons for, and the scope of, an approval sought, including the number of staff affected, their functions and the expected impact on the requirement to maintain a sound capital base;

- shareholders or owners or members of the institution shall act by a majority of at least 66 % provided that at least 50 % of the shares or equivalent ownership rights are represented or, failing that, shall act by a majority of 75 % of the ownership rights represented;
  - the institution shall notify all shareholders or owners or members of the institution, providing a reasonable notice period in advance, that an approval under the first subparagraph of this point will be sought;
  - the institution shall, without delay, inform the competent authority of the recommendation to its shareholders or owners or members, including the proposed higher maximum ratio and the reasons therefore and shall be able to demonstrate to the competent authority that the proposed higher ratio does not conflict with the institution's obligations under this Directive and under Regulation (EU) No 575/2013, having regard in particular to the institution's own funds obligations;
  - the institution shall, without delay, inform the competent authority of the decisions taken by its shareholders or owners or members, including any approved higher maximum ratio pursuant to the first subparagraph of this point, and the competent authorities shall use the information received to benchmark the practices of institutions in that regard. The competent authorities shall provide EBA with that information and EBA shall publish it on an aggregate home Member State basis in a common reporting format. EBA may elaborate guidelines to facilitate the implementation of this indent and to ensure the consistency of the information collected;
  - staff who are directly concerned by the higher maximum levels of variable remuneration referred to in this point shall not, where applicable, be allowed to exercise, directly or indirectly, any voting rights they may have as shareholders or owners or members of the institution;
- (iii) Member States may allow institutions to apply the discount rate referred to in the second subparagraph of this point to a maximum of 25 % of total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years. Member States may set a lower maximum percentage.
- EBA shall prepare and publish, by 31 March 2014, guidelines on the applicable notional discount rate
- taking into account all relevant factors including inflation rate and risk, which includes length of deferral. The EBA guidelines on the discount rate shall specifically consider how to incentivise the use of instruments which are deferred for a period of not less than five years;
- (h) payments relating to the early termination of a contract reflect performance achieved over time and do not reward failure or misconduct;
  - (i) remuneration packages relating to compensation or buy out from contracts in previous employment must align with the long-term interests of the institution including retention, deferral, performance and clawback arrangements;
  - (j) the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes an adjustment for all types of current and future risks and takes into account the cost of the capital and the liquidity required;
  - (k) the allocation of the variable remuneration components within the institution shall also take into account all types of current and future risks;
  - (l) a substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of a balance of the following:
    - (i) shares or equivalent ownership interests, subject to the legal structure of the institution concerned or share-linked instruments or equivalent non-cash instruments, in the case of a non-listed institution;
    - (ii) where possible, other instruments within the meaning of Article 52 or 63 of Regulation (EU) No 575/2013 or other instruments which can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purposes of variable remuneration.
- The instruments referred to in this point shall be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the institution. Member States or their competent authorities may place restrictions on the types and designs of those instruments or prohibit certain instruments as appropriate. This point shall be applied to both the portion of the variable remuneration component deferred in accordance with point (m) and the portion of the variable remuneration component not deferred;

EBA shall prepare and publish, by 31 March 2014, guidelines on the applicable notional discount rate

- (m) a substantial portion, and in any event at least 40 %, of the variable remuneration component is deferred over a period which is not less than three to five years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question.

Remuneration payable under deferral arrangements shall vest no faster than on a pro-rata basis. In the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount shall be deferred. The length of the deferral period shall be established in accordance with the business cycle, the nature of the business, its risks and the activities of the member of staff in question;

- (n) the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the institution as a whole, and justified on the basis of the performance of the institution, the business unit and the individual concerned.

Without prejudice to the general principles of national contract and labour law, the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the institution occurs, taking into account both current remuneration and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

Up to 100 % of the total variable remuneration shall be subject to malus or clawback arrangements. Institutions shall set specific criteria for the application of malus and clawback. Such criteria shall in particular cover situations where the staff member:

- (i) participated in or was responsible for conduct which resulted in significant losses to the institution;
  - (ii) failed to meet appropriate standards of fitness and propriety;
- (o) the pension policy is in line with the business strategy, objectives, values and long-term interests of the institution.

If the employee leaves the institution before retirement, discretionary pension benefits shall be held by the institution for a period of five years in the form of instruments referred to in point (l). Where an employee reaches retirement, discretionary pension benefits shall be paid to the employee in the form of instruments referred to in point (l) subject to a five-year retention period;

- (p) staff members are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;

- (q) variable remuneration is not paid through vehicles or methods that facilitate the non-compliance with this Directive or Regulation (EU) No 575/2013.

2. EBA shall develop draft regulatory technical standards with respect to specifying the classes of instruments that satisfy the conditions set out in point (l)(ii) of paragraph 1 and with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on the institution's risk profile as referred to in Article 92(2).

EBA shall submit those draft regulatory technical standards to the Commission by 31 March 2014.

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

#### Article 95

#### Remuneration Committee

1. Competent authorities shall ensure that institutions that are significant in terms of their size, internal organisation and the nature, the scope and the complexity of their activities establish a remuneration committee. The remuneration committee shall be constituted in such a way as to enable it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk, capital and liquidity.

2. Competent authorities shall ensure that the remuneration committee is responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the institution concerned and which are to be taken by the management body. The Chair and the members of the remuneration committee shall be members of the management body who do not perform any executive function in the institution concerned. If employee representation on the management body is provided for by national law, the remuneration committee shall include one or more employee representatives. When preparing such decisions, the remuneration committee shall take into account the long-term interests of shareholders, investors and other stakeholders in the institution and the public interest.

*Article 96***Maintenance of a website on corporate governance and remuneration**

Institutions that maintain a website shall explain there how they comply with the requirements of Articles 88 to 95.

## Section III

**Supervisory review and evaluation process***Article 97***Supervisory review and evaluation**

1. Taking into account the technical criteria set out in Article 98, the competent authorities shall review the arrangements, strategies, processes and mechanisms implemented by the institutions to comply with this Directive and Regulation (EU) No 575/2013 and evaluate:

- (a) risks to which the institutions are or might be exposed;
- (b) risks that an institution poses to the financial system taking into account the identification and measurement of systemic risk under Article 23 of Regulation (EU) No 1093/2010, or recommendations of the ESRB, where appropriate; and
- (c) risks revealed by stress testing taking into account the nature, scale and complexity of an institution's activities.

2. The scope of the review and evaluation referred to in paragraph 1 shall cover all requirements of this Directive and of Regulation (EU) No 575/2013.

3. On the basis of the review and evaluation referred to in paragraph 1, the competent authorities shall determine whether the arrangements, strategies, processes and mechanisms implemented by institutions and the own funds and liquidity held by them ensure a sound management and coverage of their risks.

4. Competent authorities shall establish the frequency and intensity of the review and evaluation referred to in paragraph 1 having regard to the size, systemic importance, nature, scale and complexity of the activities of the institution concerned and taking into account the principle of proportionality. The review and evaluation shall be updated at least on an annual basis for institutions covered by the supervisory examination programme referred to in Article 99(2).

5. Member States shall ensure that where a review shows that an institution may pose systemic risk in accordance with

Article 23 of Regulation (EU) No 1093/2010 the competent authorities inform EBA without delay about the results of the review.

*Article 98***Technical criteria for the supervisory review and evaluation**

1. In addition to credit, market and operational risks, the review and evaluation performed by competent authorities pursuant to Article 97 shall include at least:

- (a) the results of the stress test carried out in accordance with Article 177 of Regulation (EU) No 575/2013 by institutions applying an internal ratings based approach;
- (b) the exposure to and management of concentration risk by institutions, including their compliance with the requirements set out in Part Four of Regulation (EU) No 575/2013 and Article 81 of this Directive;
- (c) the robustness, suitability and manner of application of the policies and procedures implemented by institutions for the management of the residual risk associated with the use of recognised credit risk mitigation techniques;
- (d) the extent to which the own funds held by an institution in respect of assets which it has securitised are adequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved;
- (e) the exposure to, measurement and management of liquidity risk by institutions, including the development of alternative scenario analyses, the management of risk mitigants (in particular the level, composition and quality of liquidity buffers) and effective contingency plans;
- (f) the impact of diversification effects and how such effects are factored into the risk measurement system;
- (g) the results of stress tests carried out by institutions using an internal model to calculate market risk own funds requirements under Part Three, Title IV, Chapter 5 of Regulation (EU) No 575/2013;
- (h) the geographical location of institutions' exposures;
- (i) the business model of the institution;
- (j) the assessment of systemic risk, in accordance with the criteria set out in Article 97.

2. For the purposes of point (e) of paragraph 1, the competent authorities shall regularly carry out a comprehensive assessment of the overall liquidity risk management by institutions and promote the development of sound internal methodologies. While conducting those reviews, the competent authorities shall have regard to the role played by institutions in the financial markets. The competent authorities in one Member State shall duly consider the potential impact of their decisions on the stability of the financial system in all other Member States concerned.

3. Competent authorities shall monitor whether an institution has provided implicit support to a securitisation. If an institution is found to have provided implicit support on more than one occasion the competent authority shall take appropriate measures reflective of the increased expectation that it will provide future support to its securitisation thus failing to achieve a significant transfer of risk.

4. For the purposes of the determination to be made under Article 97(3) of this Directive, competent authorities shall consider whether the valuation adjustments taken for positions or portfolios in the trading book, as set out in Article 105 of Regulation (EU) No 575/2013, enable the institution to sell or hedge out its positions within a short period without incurring material losses under normal market conditions.

5. The review and evaluation performed by competent authorities shall include the exposure of institutions to the interest rate risk arising from non-trading activities. Measures shall be required at least in the case of institutions whose economic value declines by more than 20 % of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points or such change as defined in the EBA guidelines.

6. The review and evaluation performed by competent authorities shall include the exposure of institutions to the risk of excessive leverage as reflected by indicators of excessive leverage, including the leverage ratio determined in accordance with Article 429 of Regulation (EU) No 575/2013. In determining the adequacy of the leverage ratio of institutions and of the arrangements, strategies, processes and mechanisms implemented by institutions to manage the risk of excessive leverage, competent authorities shall take into account the business model of those institutions.

7. The review and evaluation conducted by competent authorities shall include governance arrangements of institutions, their corporate culture and values, and the ability of members of the management body to perform their duties. In conducting that review and evaluation, competent authorities shall, at least, have access to agendas and supporting documents for meetings of the management body and its committees, and the results of the internal or external evaluation of performance of the management body.

## Article 99

### Supervisory examination programme

1. The competent authorities shall, at least annually, adopt a supervisory examination programme for the institutions they supervise. Such programme shall take into account the supervisory review and evaluation process under Article 97. It shall contain the following:

- (a) an indication of how competent authorities intend to carry out their tasks and allocate their resources;
- (b) an identification of which institutions are intended to be subject to enhanced supervision and the measures taken for such supervision as set out in paragraph 3;
- (c) a plan for inspections at the premises used by an institution, including its branches and subsidiaries established in other Member States in accordance with Articles 52, 119 and 122.

2. Supervisory examination programmes shall include the following institutions:

- (a) institutions for which the results of the stress tests referred to in points (a) and (g) of Article 98(1) and Article 100, or the outcome of the supervisory review and evaluation process under Article 97, indicate significant risks to their ongoing financial soundness or indicate breaches of national provisions transposing this Directive and of Regulation (EU) No 575/2013;
- (b) institutions that pose systemic risk to the financial system;
- (c) any other institution for which the competent authorities deem it to be necessary.

3. Where appropriate under Article 97 the following measures shall, in particular, be taken if necessary:

- (a) an increase in the number or frequency of on-site inspections of the institution;
- (b) a permanent presence of the competent authority at the institution;
- (c) additional or more frequent reporting by the institution;
- (d) additional or more frequent review of the operational, strategic or business plans of the institution;



(e) thematic examinations monitoring specific risks that are likely to materialise.

4. Adoption of a supervisory examination programme by the competent authority of the home Member State shall not prevent the competent authorities of the host Member State from carrying out, on a case-by-case basis, on-the-spot checks and inspections of the activities carried out by branches of institutions on their territory in accordance with Article 52(3).

#### Article 100

##### Supervisory stress testing

1. The competent authorities shall carry out as appropriate but at least annually supervisory stress tests on institutions they supervise, to facilitate the review and evaluation process under Article 97.

2. EBA shall issue guidelines in accordance with Article 16 of Regulation (EU) No 1093/2010 to ensure that common methodologies are used by the competent authorities when conducting annual supervisory stress tests.

#### Article 101

##### Ongoing review of the permission to use internal approaches

1. Competent authorities shall review on a regular basis, and at least every 3 years, institutions' compliance with the requirements regarding approaches that require permission by the competent authorities before using such approaches for the calculation of own funds requirements in accordance with Part Three of Regulation (EU) No 575/2013. They shall have particular regard to changes in an institution's business and to the implementation of those approaches to new products. Where material deficiencies are identified in risk capture by an institution's internal approach, competent authorities shall ensure they are rectified or take appropriate steps to mitigate their consequences, including by imposing higher multiplication factors, or imposing capital add-ons, or taking other appropriate and effective measures.

2. The competent authorities shall in particular review and assess whether the institution uses well developed and up-to-date techniques and practices for those approaches.

3. If for an internal market risk model numerous over-shootings referred to in Article 366 of Regulation (EU) No 575/2013 indicate that the model is not or is no longer sufficiently accurate, the competent authorities shall revoke the permission for using the internal model or impose appropriate measures to ensure that the model is improved promptly.

4. If an institution has received permission to apply an approach that requires permission by the competent authorities

before using such an approach for the calculation of own funds requirements in accordance with Part Three of Regulation (EU) No 575/2013 but does not meet the requirements for applying that approach anymore, the competent authorities shall require the institution to either demonstrate to the satisfaction of the competent authorities that the effect of non-compliance is immaterial where applicable in accordance with Regulation (EU) No 575/2013 or present a plan for the timely restoration of compliance with the requirements and set a deadline for its implementation. The competent authorities shall require improvements to that plan if it is unlikely to result in full compliance or if the deadline is inappropriate. If the institution is unlikely to be able to restore compliance within an appropriate deadline and, where applicable, has not satisfactorily demonstrated that the effect of non-compliance is immaterial, the permission to use the approach shall be revoked or limited to compliant areas or those where compliance can be achieved within an appropriate deadline.

5. In order to promote consistent soundness of internal approaches in the Union, EBA shall analyse internal approaches across institutions, including the consistency of implementation of the definition of default and how those institutions treat similar risks or exposures.

EBA shall develop guidelines in accordance with Article 16 of Regulation (EU) No 1093/2010, which contain benchmarks on the basis of that analysis.

Competent authorities shall take into account that analysis and those benchmarks for the review of the permissions they grant to institutions to use internal approaches.

## Section IV

### Supervisory measures and powers

#### Article 102

##### Supervisory measures

1. Competent authorities shall require an institution to take the necessary measures at an early stage to address relevant problems in the following circumstances:

- (a) the institution does not meet the requirements of this Directive or of Regulation (EU) No 575/2013;
- (b) the competent authorities have evidence that the institution is likely to breach the requirements of this Directive or of Regulation (EU) No 575/2013 within the following 12 months.

2. For the purposes of paragraph 1, the powers of competent authorities shall include those referred to in Article 104.

*Article 103***Application of supervisory measures to institutions with similar risk profiles**

1. Where the competent authorities determine under Article 97 that institutions with similar risk profiles such as similar business models or geographical location of exposures, are or might be exposed to similar risks or pose similar risks to the financial system, they may apply the supervisory review and evaluation process referred to in Article 97 to those institutions in a similar or identical manner. For those purposes, Member States shall ensure that competent authorities have the necessary legal powers to impose requirements under this Directive and under Regulation (EU) No 575/2013 on those institutions in a similar or identical manner, including in particular the exercise of supervisory powers under Articles 104, 105 and 106.

The types of institution referred to in the first subparagraph may in particular be determined in accordance with the criteria referred to in Article 98(1)(j).

2. The competent authorities shall notify EBA where they apply paragraph 1. EBA shall monitor supervisory practices and issue guidelines to specify how similar risks should be assessed and how consistent application of paragraph 1 across the Union can be ensured. Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010

*Article 104***Supervisory powers**

1. For the purposes of Article 97, Article 98(4), Article 101(4) and Articles 102 and 103 and the application of Regulation (EU) No 575/2013, competent authorities shall have at least the following powers:

- (a) to require institutions to hold own funds in excess of the requirements set out in Chapter 4 of this Title and in Regulation (EU) No 575/2013 relating to elements of risks and risks not covered by Article 1 of that Regulation;
- (b) to require the reinforcement of the arrangements, processes, mechanisms and strategies implemented in accordance with Articles 73 and 74;
- (c) to require institutions to present a plan to restore compliance with supervisory requirements pursuant to this Directive and to Regulation (EU) No 575/2013 and set a deadline for its implementation, including improvements to that plan regarding scope and deadline;
- (d) to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements;

- (e) to restrict or limit the business, operations or network of institutions or to request the divestment of activities that pose excessive risks to the soundness of an institution;
- (f) to require the reduction of the risk inherent in the activities, products and systems of institutions;
- (g) to require institutions to limit variable remuneration as a percentage of net revenues where it is inconsistent with the maintenance of a sound capital base;
- (h) to require institutions to use net profits to strengthen own funds;
- (i) to restrict or prohibit distributions or interest payments by an institution to shareholders, members or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution;
- (j) to impose additional or more frequent reporting requirements, including reporting on capital and liquidity positions;
- (k) to impose specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities;
- (l) to require additional disclosures.

2. The additional own funds requirements referred to in paragraph 1(a) shall be imposed by the competent authorities at least where,

- (a) an institution does not meet the requirement set out in Articles 73 and 74 of this Directive or in Article 393 of Regulation (EU) No 575/2013;
- (b) risks or elements of risks are not covered by the own funds requirements set out in Chapter 4 of this Title or in Regulation (EU) No 575/2013;
- (c) the sole application of other administrative measures is unlikely to improve the arrangements, processes, mechanisms and strategies sufficiently within an appropriate timeframe;
- (d) the review referred to in Article 98(4) or Article 101(4) reveals that the non-compliance with the requirements for the application of the respective approach will likely lead to inadequate own funds requirements;

- (e) the risks are likely to be underestimated despite compliance with the applicable requirements of this Directive and of Regulation (EU) No 575/2013; or
- (f) an institution reports to the competent authority in accordance with Article 377(5) of Regulation (EU) No 575/2013 that the stress test results referred to in that Article materially exceed its own funds requirement for the correlation trading portfolio.
3. For the purposes of determining the appropriate level of own funds on the basis of the review and evaluation carried out in accordance with Section III, the competent authorities shall assess whether any imposition of an additional own funds requirement in excess of the own funds requirement is necessary to capture risks to which an institution is or might be exposed, taking into account the following:
- (a) the quantitative and qualitative aspects of an institution's assessment process referred to in Article 73;
- (b) an institution's arrangements, processes and mechanisms referred to in Article 74;
- (c) the outcome of the review and evaluation carried out in accordance with Article 97 or 101;
- (d) the assessment of systemic risk.

#### Article 105

##### Specific liquidity requirements

For the purposes of determining the appropriate level of liquidity requirements on the basis of the review and evaluation carried out in accordance with Section III, the competent authorities shall assess whether any imposition of a specific liquidity requirement is necessary to capture liquidity risks to which an institution is or might be exposed, taking into account the following:

- (a) the particular business model of the institution;
- (b) the institution's arrangements, processes and mechanisms referred to in Section II and in particular in Article 86;
- (c) the outcome of the review and evaluation carried out in accordance with Article 97;
- (d) systemic liquidity risk that threatens the integrity of the financial markets of the Member State concerned.

In particular, without prejudice to Article 67, competent authorities should consider the need to apply administrative penalties or other administrative measures, including prudential

charges, the level of which broadly relates to the disparity between the actual liquidity position of an institution and any liquidity and stable funding requirements established at national or Union level.

#### Article 106

##### Specific publication requirements

1. Member States shall empower the competent authorities to require institutions:
- (a) to publish information referred to in Part Eight of Regulation (EU) No 575/2013 more than once per year, and to set deadlines for publication;
- (b) to use specific media and locations for publications other than the financial statements.
2. Member States shall empower competent authorities to require parent undertakings to publish annually, either in full or by way of references to equivalent information, a description of their legal structure and governance and organisational structure of the group of institutions in accordance with Article 14(3), Article 74(1) and Article 109(2).

#### Article 107

##### Consistency of supervisory reviews, evaluations and supervisory measures

1. Competent authorities shall inform EBA of:
- (a) the functioning of their review and evaluation process referred to in Article 97;
- (b) the methodology used to base decisions referred to in Articles 98, 100, 101, 102, 104 and 105 on the process referred to in point (a).

EBA shall assess the information provided by competent authorities for the purposes of developing consistency in the supervisory review and evaluation process. It may request additional information from competent authorities in order to complete its assessment, on a proportional basis in accordance with Article 35 of Regulation (EU) No 1093/2010.

2. EBA shall annually report to the European Parliament and the Council on the degree of convergence of the application of this Chapter between Member States.

In order to increase the degree of such convergence, EBA shall conduct peer reviews in accordance with Article 30 of Regulation (EU) No 1093/2010.

3. EBA shall issue guidelines addressed to the competent authorities in accordance with Article 16 of Regulation (EU) No 1093/2010 to further specify, in a manner that is appropriate to the size, the structure and the internal organisation of institutions and the nature, scope and complexity of their activities, the common procedures and methodologies for the supervisory review and evaluation process referred to in paragraph 1 of this Article and in Article 97 and for the assessment of the organisation and treatment of the risks referred to in Articles 76 to 87, in particular relating to concentration risk in accordance with Article 81.

## Section V

### Level of application

#### Article 108

##### Internal capital adequacy assessment process

1. Competent authorities shall require every institution which is neither a subsidiary in the Member State where it is authorised and supervised, nor a parent undertaking, and every institution not included in the consolidation pursuant to Article 19 of Regulation (EU) No 575/2013, to meet the obligations set out in Article 73 of this Directive on an individual basis.

Competent authorities may waive the requirements set out in Article 73 of this Directive in regard to a credit institution in accordance with Article 10 of Regulation (EU) No 575/2013.

Where the competent authorities waive the application of own funds requirements on a consolidated basis provided for in Article 15 of Regulation (EU) No 575/2013, the requirements of Article 73 of this Directive shall apply on an individual basis.

2. Competent authorities shall require parent institutions in a Member State, to the extent and in the manner prescribed in Part One, Title II, Chapter 2, Sections 2 and 3 of Regulation (EU) No 575/2013 to meet the obligations set out in Article 73 of this Directive on a consolidated basis.

3. Competent authorities shall require institutions controlled by a parent financial holding company or a parent mixed financial holding company in a Member State, to the extent and in the manner prescribed in Part One, Title II, Chapter 2, Sections 2 and 3 of Regulation (EU) No 575/2013 to meet the obligations set out in Article 73 of this Directive 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 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 111.

4. Competent authorities shall require subsidiary institutions to apply the requirements set out in Article 73 on a sub-consolidated basis if those institutions, or the parent undertaking where it is a financial holding company or mixed financial holding company, have an institution or a financial institution or an asset management company as defined in Article 2(5) of Directive 2002/87/EC as a subsidiary in a third country, or hold a participation in such an undertaking.

#### Article 109

##### Institutions' arrangements, processes and mechanisms

1. Competent authorities shall require institutions to meet the obligations set out in Section II of this Chapter on an individual basis, unless competent authorities make use of the derogation provided for in Article 7 of Regulation (EU) No 575/2013.

2. Competent authorities shall require the parent undertakings and subsidiaries subject to this Directive to meet the obligations set out in Section II of this Chapter on a consolidated or sub-consolidated basis, to ensure that their arrangements, processes and mechanisms required by Section II of this Chapter 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 parent undertakings and subsidiaries subject to this Directive implement such arrangements, processes and mechanisms in their subsidiaries not subject to this Directive. Those arrangements, processes and mechanisms shall also be consistent and well-integrated and those subsidiaries shall also be able to produce any data and information relevant to the purpose of supervision.

3. Obligations resulting from Section II of this Chapter concerning subsidiary undertakings, not themselves subject to this Directive, 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 Section II is unlawful under the laws of the third country where the subsidiary is established.

#### Article 110

##### Review and evaluation and supervisory measures

1. Competent authorities shall apply the review and evaluation process referred to in Section III of this Chapter and the supervisory measures referred to in Section IV of this Chapter in accordance with the level of application of the requirements of Regulation (EU) No 575/2013 set out in Part One, Title II of that Regulation.

2. Where the competent authorities waive the application of own funds requirements on a consolidated basis as provided for in Article 15 of Regulation (EU) No 575/2013, the requirements of Article 97 of this Directive shall apply to the supervision of investment firms on an individual basis.

## CHAPTER 3

### **Supervision on a consolidated basis**

#### Section I

### **Principles for conducting supervision on a consolidated basis**

#### *Article 111*

##### **Determination of the consolidating supervisor**

1. Where a parent undertaking is a parent institution in a Member State or an EU parent institution, supervision on a consolidated basis shall be exercised by the competent authorities that granted authorisation.

2. Where the parent of an institution is a parent financial holding company or parent mixed financial holding company in a Member State or an EU parent financial holding company or EU parent mixed financial holding company, supervision on a consolidated basis shall be exercised by the competent authorities that granted authorisation.

3. Where institutions authorised in two or more Member States have as their parent the same parent financial holding company, the same parent mixed financial holding company in a Member State, the same EU parent financial holding company or the same EU parent mixed financial holding company, supervision on a consolidated basis shall be exercised by the competent authorities of the institution authorised in the Member State in which the financial holding company or mixed financial holding company was set up.

Where the parent undertakings of institutions authorised in two or more Member States comprise more than one financial holding company or mixed financial holding company with head offices in different Member States and there is a credit institution in each of those States, supervision on a consolidated basis shall be exercised by the competent authority of the credit institution with the largest balance sheet total.

4. Where more than one institution authorised in the Union has as its parent the same financial holding company or mixed financial holding company and none of those institutions has been authorised in the Member State in which the financial holding company or mixed financial holding company was set up, supervision on a consolidated basis shall be exercised by the competent authority that authorised the institution with the largest balance sheet total, which shall be considered, for the purposes of this Directive, as the institution controlled by an EU parent financial holding company or EU parent mixed financial holding company.

5. In particular cases, the competent authorities may, by common agreement, waive the criteria referred to in paragraphs 3 and 4 if their application would be inappropriate, taking into account the institutions and the relative importance of their activities in different countries, and appoint a different competent authority to exercise supervision on a consolidated basis. In such cases, before taking their decision, the competent authorities shall give the EU parent institution, EU parent financial holding company, EU parent mixed financial holding company, or institution with the largest balance sheet total, as appropriate, an opportunity to state its opinion on that decision.

6. The competent authorities shall notify the Commission and EBA of any agreement falling within paragraph 5.

#### *Article 112*

### **Coordination of supervisory activities by the consolidating supervisor**

1. In addition to the obligations imposed by this Directive and by Regulation (EU) No 575/2013, the consolidating supervisor shall carry out the following tasks:

- (a) coordination of the gathering and dissemination of relevant or essential information in going concern and emergency situations;
- (b) planning and coordination of supervisory activities in going-concern situations, including in relation to the activities referred to in Title VII, Chapter 3, in cooperation with the competent authorities involved;
- (c) planning and coordination of supervisory activities in cooperation with the competent authorities involved, and if necessary with ESCB central banks, in preparation for and during emergency situations, including adverse developments in institutions or in financial markets using, where possible, existing channels of communication for facilitating crisis management.

2. Where the consolidating supervisor fails to carry out the tasks referred to in paragraph 1 or where the competent authorities do not cooperate with the consolidating supervisor to the extent required in carrying out the tasks in paragraph 1, any of the competent authorities concerned may refer the matter to EBA and request its assistance under Article 19 of Regulation (EU) No 1093/2010.

EBA may also assist the competent authorities in the event of a disagreement concerning the coordination of supervisory activities under this Article on its own initiative in accordance with the second subparagraph of Article 19(1) of that Regulation.



3. The planning and coordination of supervisory activities referred to in paragraph 1(c) of this Article includes exceptional measures referred to in Article 117(1)(d) and Article 117(4)(b), the preparation of joint assessments, the implementation of contingency plans and communication to the public.

#### Article 113

##### **Joint decisions on institution-specific prudential requirements**

1. 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:

- (a) on the application of Articles 73 and 97 to determine the adequacy of the consolidated level of own funds held by the group of institutions with respect to its financial situation and risk profile and the required level of own funds for the application of Article 104(1)(a) to each entity within the group of institutions and on a consolidated basis;
- (b) on measures to address any significant matters and material findings relating to liquidity supervision including relating to the adequacy of the organisation and the treatment of risks as required pursuant to Article 86 and relating to the need for institution-specific liquidity requirements in accordance with Article 105 of this Directive.

2. The joint decisions referred to in paragraph 1 shall be reached:

- (a) for the purpose of paragraph 1(a), within four months after submission by the consolidating supervisor of a report containing the risk assessment of the group of institutions in accordance with Articles 73 and 97 and Article 104(1)(a) to the other relevant competent authorities;
- (b) for the purposes of paragraph 1(b), within one month after submission by the consolidating supervisor of a report containing the assessment of the liquidity risk profile of the group of institutions in accordance with Articles 86 and 105.

The joint decisions shall also duly consider the risk assessment of subsidiaries performed by relevant competent authorities in accordance with Articles 73 and 97.

The joint decisions shall be set out in documents containing full reasons which shall be provided to the EU parent institution by the consolidating supervisor. In the event of disagreement, the

consolidating supervisor shall at the request of any of the other competent authorities concerned consult EBA. The consolidating supervisor may consult EBA on its own initiative.

3. In the absence of such a joint decision between the competent authorities within the time periods referred to in paragraph 2, a decision on the application of Articles 73, 86 and 97, Article 104(1)(a) and Article 105 shall be taken on a consolidated basis by the consolidating supervisor after duly considering the risk assessment of subsidiaries performed by relevant competent authorities. If, at the end of the time periods referred to in paragraph 2, any of the competent authorities concerned has referred the matter to EBA in accordance with Article 19 of Regulation (EU) No 1093/2010, the consolidating supervisor shall defer its decision and await any decision that EBA may take in accordance with Article 19(3) of that Regulation, and shall take its decision in conformity with the decision of EBA. The time periods referred to in paragraph 2 shall be deemed the conciliation periods within the meaning of Regulation (EU) No 1093/2010. EBA shall take its decision within 1 month. The matter shall not be referred to EBA after the end of the four month period or one-month period, as applicable, or after a joint decision has been reached.

The decision on the application of Articles 73, 86 and 97, Article 104(1)(a) and Article 105 shall be taken by the respective competent authorities responsible for supervision of subsidiaries of an EU parent credit institution or a EU parent financial holding company or EU parent mixed financial holding company on an individual or sub-consolidated basis after duly considering the views and reservations expressed by the consolidating supervisor. If, at the end of any of the time periods referred to in paragraph 2, any of the competent authorities concerned has referred the matter to EBA in accordance with Article 19 of Regulation (EU) No 1093/2010, the competent authorities shall defer their decision and await any decision that EBA shall take in accordance with Article 19(3) of that Regulation, and shall take their decision in conformity with the decision of EBA. The time periods referred to in paragraph 2 shall be deemed the conciliation periods 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 four-month or one-month period, as applicable, or after a joint decision has been reached.

The decisions shall be set out in a document containing full reasons and shall take into account the risk assessment, views and reservations of the other competent authorities expressed during the time periods referred to in paragraph 2. The document shall be provided by the consolidating supervisor to all competent authorities concerned and to the EU parent institution.

Where EBA has been consulted, all the competent authorities shall consider its advice, and explain any significant deviation therefrom.

4. The joint decisions referred to in paragraph 1 and the decisions taken by the competent authorities in the absence of a joint decision referred to in paragraph 3 shall be recognised as determinative and applied by the competent authorities in the Member States concerned.

The joint decisions referred to in the paragraph 1 and any decision taken in the absence of a joint decision in accordance with paragraph 3, shall be updated on an annual basis or, in exceptional circumstances, where a competent authority 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 makes a written and fully reasoned request to the consolidating supervisor to update the decision on the application of Article 104(1)(a) and Article 105. In the latter case, the update may be addressed on a bilateral basis between the consolidating supervisor and the competent authority making the request.

5. EBA shall develop draft implementing technical standards to ensure uniform conditions of application of the joint decision process referred to in this Article, with regard to the application of Articles 73, 86 and 97, Article 104(1)(a) and Article 105 with a view to facilitating joint decisions.

EBA shall submit those draft implementing technical standards to the Commission by 1 July 2014.

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

#### *Article 114*

##### **Information requirements in emergency situations**

1. Where an emergency situation, including a situation as described in Article 18 of Regulation (EU) No 1093/2010 or a situation of adverse developments in markets, arises, which potentially jeopardises the market liquidity and the stability of the financial system in any of the Member State where entities of a group have been authorised or where significant branches referred to in Article 51 are established, the consolidating supervisor shall, subject to Chapter 1, Section 2, and where applicable Articles 54 and 58 of Directive 2004/39/EC, alert as soon as is practicable, EBA and the authorities referred to in Article 58(4) and Article 59 and shall communicate all information essential for the pursuance of their tasks. Those obligations shall apply to all competent authorities.

If an ESCB central bank becomes aware of a situation described in the first subparagraph, it shall alert as soon as is practicable the competent authorities referred to in Article 112, and EBA.

Where possible, the competent authority and the authority referred to in Article 58(4) shall use existing channels of communication.

2. The consolidating supervisor shall, where it needs information which has already been given to another competent authority, contact that authority where possible in order to prevent duplication of reporting to the various authorities involved in supervision.

#### *Article 115*

##### **Coordination and cooperation arrangements**

1. In order to facilitate and establish effective supervision, the consolidating supervisor and the other competent authorities shall have written coordination and cooperation arrangements in place.

Under those arrangements additional tasks may be entrusted to the consolidating supervisor and procedures for the decision-making process and for cooperation with other competent authorities, may be specified.

2. The competent authorities responsible for authorising the subsidiary of a parent undertaking which is an institution may, by bilateral agreement, in accordance with Article 28 of Regulation (EU) No 1093/2010, delegate their responsibility for supervision to the competent authorities which authorised and supervise the parent undertaking so that they assume responsibility for supervising the subsidiary in accordance with this Directive. EBA shall be kept informed of the existence and content of such agreements. It shall forward such information to the competent authorities of the other Member States and to the European Banking Committee.

#### *Article 116*

##### **Colleges of supervisors**

1. The consolidating supervisor shall establish colleges of supervisors to facilitate the exercise of the tasks referred to in Articles 112 and 113 and Article 114(1) and subject to the confidentiality requirements of paragraph 2 of this Article and to Union law, ensure appropriate coordination and cooperation with relevant third-country supervisory authorities where appropriate.

EBA shall contribute to promoting and monitoring the efficient, effective and consistent functioning of colleges of supervisors referred to in this Article in accordance with Article 21 of Regulation (EU) No 1093/2010. To that end, EBA shall participate as appropriate and shall be considered to be a competent authority for that purpose.

Colleges of supervisors shall provide a framework for the consolidating supervisor, EBA and the other competent authorities concerned to carry out the following tasks:

- (a) exchanging information between each other and with EBA in accordance with Article 21 of Regulation (EU) No 1093/2010;
- (b) agreeing on voluntary entrustment of tasks and voluntary delegation of responsibilities where appropriate;
- (c) determining supervisory examination programmes referred to in Article 99 based on a risk assessment of the group in accordance with Article 97;
- (d) increasing the efficiency of supervision by removing unnecessary duplication of supervisory requirements, including in relation to the information requests referred to in Article 114 and Article 117(3);
- (e) consistently applying the prudential requirements under this Directive and under Regulation (EU) No 575/2013 across all entities within a group of institutions without prejudice to the options and discretions available in Union law;
- (f) applying Article 112(1)(c) taking into account the work of other forums that may be established in that area.

2. The competent authorities participating in the colleges of supervisors and EBA shall cooperate closely. The confidentiality requirements under Chapter 1, Section II of this Directive, and Articles 54 and 58 of Directive 2004/39/EC shall not prevent the competent authorities from exchanging confidential information within colleges of supervisors. The establishment and functioning of colleges of supervisors shall not affect the rights and responsibilities of the competent authorities under this Directive and under Regulation (EU) No 575/2013.

3. The establishment and functioning of the colleges shall be based on written arrangements referred to in Article 115, determined after consulting competent authorities concerned by the consolidating supervisor.

4. EBA shall develop draft regulatory technical standards in order to specify general conditions of functioning of the colleges of supervisors.

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

5. EBA shall develop draft implementing technical standards in order to determine the operational functioning of the colleges of supervisors.

EBA 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 Article 15 of Regulation (EU) No 1093/2010.

6. 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 and the competent authorities of a host Member State where significant branches as referred to in Article 51 are established, ESCB central banks as appropriate, and third countries' supervisory authorities where appropriate and subject to confidentiality requirements that are equivalent, in the opinion of all competent authorities, to the requirements under Chapter 1, Section II of this Directive and where applicable, Articles 54 and 58 of Directive 2004/39/EC, may participate in colleges of supervisors.

7. The consolidating supervisor shall chair the meetings of the college and shall decide which competent authorities participate in a meeting or in an activity of the college. The consolidating supervisor shall keep all members of the college fully informed, in advance, of the organisation of such meetings, the main issues to be discussed and the activities to be considered. The consolidating supervisor shall also keep all the members of the college fully informed, in a timely manner, of the actions taken in those meetings or the measures carried out.

8. The decision of the consolidating supervisor shall take account of the relevance of the supervisory activity to be planned or coordinated for those authorities, in particular the potential impact on the stability of the financial system in the Member States concerned as referred to in Article 7 and the obligations referred to in Article 51(2).

9. The consolidating supervisor, subject to the confidentiality requirements under Chapter 1, Section II, of this Directive, and where applicable, Articles 54 and 58 of Directive 2004/39/EC, shall inform EBA of the activities of the college of supervisors, including in emergency situations, and communicate to EBA all information that is of particular relevance for the purposes of supervisory convergence.

In the event of a disagreement between competent authorities on the functioning of supervisory colleges, any of the competent authorities concerned may refer the matter to EBA and request its assistance in accordance with Article 19 of Regulation (EU) No 1093/2010.

EBA may also assist the competent authorities in the event of a disagreement concerning the functioning of supervisory colleges under this Article on its own initiative in accordance with the second subparagraph of Article 19(1) of that Regulation.

#### Article 117

##### Cooperation obligations

1. The competent authorities shall cooperate closely with each other. They shall provide one another with any information which is essential or relevant for the exercise of the other authorities' supervisory tasks under this Directive and Regulation (EU) No 575/2013. In that regard, the competent authorities shall communicate on request all relevant information and shall communicate on their own initiative all essential information.

The competent authorities shall cooperate with EBA for the purposes of this Directive and Regulation (EU) No 575/2013, in accordance with Regulation (EU) No 1093/2010.

The competent authorities shall provide EBA with all information necessary to carry out its duties under this Directive, under Regulation (EU) No 575/2013, and under Regulation (EU) No 1093/2010, in accordance with Article 35 of Regulation (EU) No 1093/2010.

Information referred to in the first subparagraph shall be regarded as essential if it could materially influence the assessment of the financial soundness of an institution or financial institution in another Member State.

In particular, consolidating supervisors of EU parent institutions and institutions controlled by EU parent financial holding companies or EU parent mixed financial holding companies shall provide the competent authorities in other Member States who supervise subsidiaries of those parent undertakings with all relevant information. In determining the extent of relevant information, the importance of those subsidiaries within the financial system in those Member States shall be taken into account.

The essential information referred to in the first subparagraph shall include, in particular, the following items:

(a) identification of the group's legal structure and the governance structure including organisational structure, covering all regulated entities, non-regulated entities, non-regulated subsidiaries and significant branches belonging to

the group, the parent undertakings, in accordance with Article 14(3), Article 74(1) and Article 109(2), and of the competent authorities of the regulated entities in the group;

(b) procedures for the collection of information from the institutions in a group, and the checking of that information;

(c) adverse developments in institutions or in other entities of a group, which could seriously affect the institutions;

(d) significant penalties and exceptional measures taken by competent authorities in accordance with this Directive, including the imposition of a specific own fund requirement under Article 104 and the imposition of any limitation on the use of the Advanced Measurement Approach for the calculation of the own funds requirements under Article 312(2) of Regulation (EU) No 575/2013.

2. The competent authorities may refer to EBA any of the following situations:

(a) where a competent authority has not communicated essential information;

(b) where a request for cooperation, in particular to exchange relevant information, has been rejected or has not been acted upon within a reasonable time.

Without prejudice to Article 258 TFEU, EBA may act in accordance with the powers conferred on it under Article 19 of Regulation (EU) No 1093/2010.

EBA may also assist the competent authorities in developing consistent cooperation practices on its own initiative in accordance with the second subparagraph of Article 19(1) of that Regulation.

3. The competent authorities responsible for the supervision of institutions controlled by an EU parent institution shall where possible contact the consolidating supervisor when they need information regarding the implementation of approaches and methodologies set out in this Directive and in Regulation (EU) No 575/2013 that may already be available to the consolidating supervisor.

4. The competent authorities concerned shall, before taking a decision, consult each other with regard to the following items, where such a decision are of importance for other competent authorities' supervisory tasks:

(a) changes in the shareholder, organisational or management structure of credit institutions in a group, which require the approval or authorisation of competent authorities; and



(b) significant penalties or exceptional measures taken by competent authorities, including the imposition of a specific own funds requirement under Article 104 and the imposition of any limitation on the use of the advances measurement approaches for the calculation of the own funds requirements under Article 312(2) of Regulation (EU) No 575/2013.

For the purposes of point (b), the consolidating supervisor shall always be consulted.

However, a competent authority may decide not to consult other competent authorities in cases of urgency or where such consultation could jeopardise the effectiveness of its decision. In such cases, the competent authority shall, without delay, inform the other competent authorities after taking its decision.

#### Article 118

#### Checking information concerning entities in other Member States

Where, in applying this Directive and Regulation (EU) No 575/2013, the competent authorities of one Member State wish in specific cases to check the information concerning an institution, a financial holding company, a mixed financial holding company, a financial institution, an ancillary services undertaking, a mixed-activity holding company, a subsidiary as referred to in Article 125 or a subsidiary as referred to in Article 119(3), situated in another Member State, they shall ask the competent authorities of that other Member State to have that check carried out. The authorities which receive such a request shall, within the framework of their competence, act upon it either by carrying out the check themselves, by allowing the authorities who made the request to carry it out, or by allowing an auditor or expert to carry it out. The competent authority which made the request may, if it so wishes, participate in the check where it does not carry out the check itself.

#### Section II

#### Financial holding companies, mixed financial holding companies and mixed-activity holding companies

#### Article 119

#### Inclusion of holding companies in consolidated supervision

1. Member States shall adopt any measures necessary, where appropriate, to include financial holding companies and mixed financial holding companies in consolidated supervision.

2. Where a subsidiary that is an institution is not included in supervision on a consolidated basis under one of the cases provided for in Article 19 of Regulation (EU) No 575/2013, the competent authorities of the Member State in which that subsidiary is situated may ask the parent undertaking for information which may facilitate their supervision of that subsidiary.

3. Member States shall enable their competent authorities responsible for exercising supervision on a consolidated basis to ask the subsidiaries of an institution, a financial holding company or mixed financial holding company, which are not included within the scope of supervision on a consolidated basis for the information referred to in Article 122. In such a case, the procedures for transmitting and checking the information set out in that Article shall apply.

#### Article 120

#### Supervision of mixed financial holding companies

1. Where a mixed financial holding company is subject to equivalent provisions under this Directive and under Directive 2002/87/EC, in particular in terms of risk-based supervision, the consolidating supervisor may, after consulting the other competent authorities responsible for the supervision of subsidiaries, apply only Directive 2002/87/EC to that mixed financial holding company.

2. Where a mixed financial holding company is subject to equivalent provisions under this Directive and under Directive 2009/138/EC, in particular in terms of risk-based supervision, the consolidating supervisor may, in agreement with the group supervisor in the insurance sector, apply to that mixed financial holding company only the provisions of this Directive relating to the most significant financial sector as defined in Article 3(2) of Directive 2002/87/EC.

3. The consolidating supervisor shall inform EBA and EIOPA of the decisions taken under paragraphs 1 and 2.

4. EBA, EIOPA and ESMA shall, through the Joint Committee referred to in Article 54 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010, develop guidelines aiming to converge supervisory practices and shall, within three years of the adoption of those guidelines, develop draft regulatory technical standards for the same purpose.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010.

#### Article 121

#### Qualification of directors

Member States shall require that the members of the management body of a financial holding company or mixed financial holding company be of sufficiently good repute and possess sufficient knowledge, skills and experience as referred to in Article 91(1) to perform those duties, taking into account the specific role of a financial holding company or mixed financial holding company.



*Article 122***Requests for information and inspections**

1. Pending further coordination of consolidation methods, Member States shall provide that, where the parent undertaking of one or more institutions is a mixed-activity holding company, the competent authorities responsible for the authorisation and supervision of those institutions shall, by approaching the mixed-activity holding company and its subsidiaries either directly or via subsidiaries that are institutions, require them to supply any information which would be relevant for the purpose of supervising those subsidiaries.

2. Member States shall provide that their competent authorities may carry out, or have carried out by external inspectors, on-the-spot inspections to check information received from mixed-activity holding companies and their subsidiaries. If the mixed-activity holding company or one of its subsidiaries is an insurance undertaking, the procedure set out in Article 125 may also be used. If a mixed-activity holding company or one of its subsidiaries is situated in a Member State other than that in which a subsidiary that is an institution is situated, on-the-spot check of information shall be carried out in accordance with the procedure set out in Article 118.

*Article 123***Supervision**

1. Without prejudice to Part Four of Regulation (EU) No 575/2013, Member States shall provide that, where the parent undertaking of one or more institutions is a mixed-activity holding company, the competent authorities responsible for the supervision of those institutions shall exercise general supervision over transactions between the institution and the mixed-activity holding company and its subsidiaries.

2. Competent authorities shall require institutions to have in place adequate risk management processes and internal control mechanisms, including sound reporting and accounting procedures in order to identify, measure, monitor and control transactions with their parent mixed-activity holding company and its subsidiaries appropriately. Competent authorities shall require the reporting by the institution of any significant transaction with those entities other than the one referred to in Article 394 of Regulation (EU) No 575/2013. Those procedures and significant transactions shall be subject to overview by the competent authorities.

*Article 124***Exchange of information**

1. Member States shall ensure that there are no legal impediments preventing the exchange, as between undertakings included within the scope of supervision on a consolidated basis, mixed-activity holding companies and their subsidiaries,

or subsidiaries as referred to in Article 119(3), of any information which would be relevant for the purposes of supervision in accordance with Article 110 and Chapter 3.

2. Where a parent undertaking and any of its subsidiaries that are institutions are situated in different Member States, the competent authorities of each Member State shall communicate to each other all relevant information which may allow or aid the exercise of supervision on a consolidated basis.

Where the competent authorities of the Member State in which a parent undertaking is situated do not themselves exercise supervision on a consolidated basis pursuant to Article 111, they may be invited by the competent authorities responsible for exercising such supervision to ask the parent undertaking for any information which would be relevant for the purposes of supervision on a consolidated basis and to transmit it to those authorities.

3. Member States shall authorise the exchange between their competent authorities of the information referred to in paragraph 2, on the understanding that, in the case of financial holding companies, mixed financial holding companies, financial institutions or ancillary services undertakings, the collection or possession of information shall not imply that the competent authorities are required to play a supervisory role in relation to those institutions or undertakings standing alone.

Similarly, Member States shall authorise their competent authorities to exchange the information referred to in Article 122 on the understanding that the collection or possession of information does not imply that the competent authorities play a supervisory role in relation to the mixed-activity holding company and those of its subsidiaries which are not credit institutions, or to subsidiaries as referred to in Article 119(3).

*Article 125***Cooperation**

1. Where an institution, financial holding company, mixed financial holding company or a mixed-activity holding company controls one or more subsidiaries which are insurance companies or other undertakings providing investment services which are subject to authorisation, the competent authorities and the authorities entrusted with the public task of supervising insurance undertakings or those other undertakings providing investment services shall cooperate closely. Without prejudice to their respective responsibilities, those authorities shall provide one another with any information likely to simplify their task and to allow supervision of the activity and overall financial situation of the undertakings they supervise.

2. Information received, within the framework of supervision on a consolidated basis, and in particular any exchange of information between competent authorities which is provided for in this Directive, shall be subject to professional secrecy requirements at least equivalent to those referred to in Article 53(1) of this Directive for credit institutions or under Directive 2004/39/EC for investment firms.

3. The competent authorities responsible for supervision on a consolidated basis shall establish lists of the financial holding companies or mixed financial holding companies referred to in Article 11 of Regulation (EU) No 575/2013. Those lists shall be communicated to the competent authorities of the other Member States, to EBA and to the Commission.

#### Article 126

##### Penalties

In accordance with Chapter 1, Section IV of this Title, Member States shall ensure that administrative penalties or other administrative measures aiming to end observed breaches or the causes of such breaches may be imposed on financial holding companies, mixed financial holding companies, and mixed-activity holding companies, or their effective managers, that breach laws, regulations or administrative provisions transposing this Chapter.

#### Article 127

##### Assessment of equivalence of third countries' consolidated supervision

1. Where an institution, the parent undertaking of which is an institution or a financial holding company or mixed financial holding company, the head office of which is in a third country, is not subject to consolidated supervision under Articles 111, the competent authorities shall assess whether the institution is subject to consolidated supervision by a third-country supervisory authority which is equivalent to that governed by the principles set out in this Directive and the requirements of Part One, Title II, Chapter 2 of Regulation (EU) No 575/2013.

The assessment shall be carried out by the competent authority which would be responsible for consolidated supervision if paragraph 3 were to apply, at the request of the parent undertaking or of any of the regulated entities authorised in the Union or on its own initiative. That competent authority shall consult the other competent authorities involved.

2. The Commission may request the European Banking Committee to give general guidance as to whether the consolidated supervision arrangements of supervisory authorities in third countries are likely to achieve the objectives of consolidated supervision as set out in this Chapter, in relation to institutions the parent undertaking of which has its head office in a third country. The European Banking Committee shall keep any such guidance under review and take into account any changes to the consolidated supervision

arrangements applied by such competent authorities. EBA shall assist the Commission and the European Banking Committee in carrying out those tasks, including as to assessing whether such guidance should be updated.

The competent authority carrying out the assessment referred to in the first subparagraph of paragraph 1 shall take into account any such guidance. For that purpose, the competent authority shall consult EBA before adopting a decision.

3. In the absence of such equivalent supervision, Member States shall apply this Directive and Regulation (EU) No 575/2013 to the institution *mutatis mutandis* or shall allow their competent authorities to apply other appropriate supervisory techniques which achieve the objectives of supervision on a consolidated basis of institutions.

Those supervisory techniques shall, after consulting the other competent authorities involved, be agreed upon by the competent authority which would be responsible for consolidated supervision.

Competent authorities may in particular require the establishment of a financial holding company or mixed financial holding company which has its head office in the Union, and apply the provisions on consolidated supervision to the consolidated position of that financial holding company or the consolidated position of the institutions of that mixed financial holding company.

The supervisory techniques shall be designed to achieve the objectives of consolidated supervision as set out in this Chapter and shall be notified to the other competent authorities involved, to EBA and to the Commission.

#### CHAPTER 4

##### Capital Buffers

##### Section I

##### Buffers

##### Article 128

##### Definitions

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

- (1) 'capital conservation buffer' means the own funds that an institution is required to maintain in accordance with Article 129;
- (2) 'institution-specific countercyclical capital buffer' means the own funds that an institution is required to maintain in accordance with Article 130;

- (3) 'G-SII buffer' means the own funds that are required to be maintained in accordance with Article 131(4);
- (4) 'O-SII buffer' means the own funds that may be required to be maintained in accordance with Article 131(5);
- (5) 'systemic risk buffer' means the own funds that an institution is or may be required to maintain in accordance with Article 133;
- (6) 'combined buffer requirement' means the total Common Equity Tier 1 capital required to meet the requirement for the capital conservation buffer extended by the following, as applicable:
- (a) an institution-specific countercyclical capital buffer;
  - (b) a G-SII buffer;
  - (c) an O-SII buffer;
  - (d) a systemic risk buffer;
- (7) 'countercyclical buffer rate' means the rate that institutions must apply in order to calculate their institution-specific countercyclical capital buffer, and that is set in accordance with Article 136, Article 137 or by a relevant third-country authority, as the case may be;
- (8) 'domestically authorised institution' means an institution that has been authorised in the Member State for which a particular designated authority is responsible for setting the countercyclical buffer rate;
- (9) 'buffer guide' means a benchmark buffer rate calculated in accordance with Article 135(1).

This Chapter shall not apply to 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.

#### Article 129

##### Requirement to maintain a capital conservation buffer

1. Member States shall require institutions to maintain in addition to the Common Equity Tier 1 capital maintained to meet the own funds requirement imposed by Article 92 of Regulation (EU) No 575/2013, a capital conservation buffer of Common Equity Tier 1 capital equal to 2,5 % of their total risk exposure amount calculated in accordance with Article 92(3) of that Regulation on an individual and consolidated basis, as applicable in accordance with Part One, Title II of that Regulation.

2. By way of derogation from paragraph 1, a Member State may exempt small and medium-sized investment firms from the requirements set out in that paragraph if such an exemption does not threaten the stability of the financial system of that Member State.

The decision on the application of such an exemption shall be fully reasoned, shall include an explanation as to why the exemption does not threaten the stability of the financial system of the Member State and shall contain the exact definition of the small and medium-sized investment firms which are exempt.

Member States which decide to apply such an exemption shall notify the Commission, the ESRB, EBA and the competent authorities of the Member States concerned accordingly.

3. For the purpose of paragraph 2, the Member State shall designate the authority in charge of the application of this Article. That authority shall be the competent authority or the designated authority.

4. For the purpose of paragraph 2, investment firms shall be categorised as small or medium-sized in accordance with Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises <sup>(1)</sup>.

5. Institutions shall not use Common Equity Tier 1 capital that is maintained to meet the requirement under paragraph 1 of this Article to meet any requirements imposed under Article 104.

6. Where an institution fails to meet fully the requirement under paragraph 1 of this Article, it shall be subject to the restrictions on distributions set out in Article 141(2) and (3).

#### Article 130

##### Requirement to maintain an institution-specific countercyclical capital buffer

1. Member States shall require institutions to maintain an institution-specific countercyclical capital buffer equivalent to their total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013 multiplied by the weighted average of the countercyclical buffer rates calculated in accordance with Article 140 of this Directive on an individual and consolidated basis, as applicable in accordance with Part One, Title II of that Regulation.

<sup>(1)</sup> OJ L 124, 20.5.2003, p. 36.

2. By way of derogation from paragraph 1, a Member State may exempt small and medium-sized investment firms from the requirements set out in that paragraph if such an exemption does not threaten the stability of the financial system of that Member State.

The decision on the application of such an exemption shall be fully reasoned, shall include an explanation as to why the exemption does not threaten the stability of the financial system of the Member State and shall contain the exact definition of small and medium-sized investment firms which are exempt.

Member States which decide to apply such an exemption shall notify the Commission, the ESRB, EBA and the competent authorities of the Member States concerned accordingly.

3. For the purpose of paragraph 2, the Member State shall designate the authority in charge of the application of this Article. That authority shall be the competent authority or the designated authority.

4. For the purpose of paragraph 2, investment firms shall be categorised as small and medium-sized in accordance with Recommendation 2003/361/EC.

5. Institutions shall meet the requirement imposed by paragraph 1 with Common Equity Tier 1 capital, which shall be additional to any Common Equity Tier 1 capital maintained to meet the own funds requirement imposed by Article 92 of Regulation (EU) No 575/2013, the requirement to maintain a capital conservation buffer under Article 129 of this Directive and any requirement imposed under Article 104 of this Directive.

6. Where an institution fails to meet fully the requirement under paragraph 1 of this Article, it shall be subject to the restrictions on distributions set out in Article 141(2) and (3).

#### Article 131

##### Global and other systemically important institutions

1. Member States shall designate the authority in charge of identifying, on a consolidated basis, global systemically important institutions (G-SIIs), and, on an individual, sub-consolidated or consolidated basis, as applicable, other systemically important institutions (O-SIIs), which have been authorised within their jurisdiction. That authority shall be the competent authority or the designated authority. Member States may designate more than one authority. G-SIIs shall be an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or

an institution. G-SIIs shall not be an institution that is a subsidiary of an EU parent institution, of an EU parent financial holding company or of an EU parent mixed financial holding company. O-SIIs can either be an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or an institution.

2. The identification methodology for G-SIIs shall be based on the following categories:

- (a) size of the group;
- (b) interconnectedness of the group with the financial system;
- (c) substitutability of the services or of the financial infrastructure provided by the group;
- (d) complexity of the group;
- (e) cross-border activity of the group, including cross border activity between Member States and between a Member State and a third country.

Each category shall receive an equal weighting and shall consist of quantifiable indicators.

The methodology shall produce an overall score for each entity as referred to in paragraph 1 assessed, which allows G-SIIs to be identified and allocated into a sub-category as described in paragraph 9.

3. O-SIIs shall be identified in accordance with paragraph 1. Systemic importance shall be assessed on the basis of at least any of the following criteria:

- (a) size;
- (b) importance for the economy of the Union or of the relevant Member State;
- (c) significance of cross-border activities;
- (d) interconnectedness of the institution or group with the financial system.

EBA, after consulting the ESRB, shall publish guidelines by 1 January 2015 on the criteria to determine the conditions of application of this paragraph in relation to the assessment of O-SIIs. Those guidelines shall take into account international frameworks for domestic systemically important institutions and Union and national specificities.

4. Each G-SII shall, on a consolidated basis, maintain a G-SII buffer which shall correspond to the sub-category to which the G-SII is allocated. That buffer shall consist of and shall be supplementary to Common Equity Tier 1 capital.

5. The competent authority or designated authority may require each O-SII, on a consolidated or sub-consolidated or individual basis, as applicable, to maintain an O-SII buffer of up to 2 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, taking into account the criteria for the identification of the O-SII. That buffer shall consist of and shall be supplementary to Common Equity Tier 1 capital.

6. When requiring an O-SII buffer to be maintained the competent authority or the designated authority shall comply with the following:

- (a) the O-SII buffer must not entail disproportionate adverse effects on the whole or parts of the financial system of other Member States or of the Union as a whole forming or creating an obstacle to the functioning of the internal market;
- (b) the O-SII buffer must be reviewed by the competent authority or the designated authority at least annually.

7. Before setting or resetting an O-SII buffer, the competent authority or the designated authority shall notify the Commission, the ESRB, EBA, and the competent and designated authorities of the Member States concerned one month before the publication of the decision referred to in paragraph 5. That notification shall describe in detail:

- (a) the justification for why the O-SII buffer is considered likely to be effective and proportionate to mitigate the risk;
- (b) an assessment of the likely positive or negative impact of the O-SII buffer on the internal market, based on information which is available to the Member State;
- (c) the O-SII buffer rate that the Member State wishes to set.

8. Without prejudice to Article 133 and paragraph 5 of this Article, where an O-SII is a subsidiary of either a G-SII or an O-SII which is an EU parent institution and subject to an O-SII

buffer on a consolidated basis, the buffer that applies at individual or sub-consolidated level for the O-SII shall not exceed the higher of:

- (a) 1 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013; and
- (b) the G-SII or O-SII buffer rate applicable to the group at consolidated level.

9. There shall be at least five subcategories of G-SIIs. The lowest boundary and the boundaries between each subcategory shall be determined by the scores under the identification methodology. The cut-off scores between adjacent sub-categories shall be defined clearly and shall adhere to the principle that there is a constant linear increase of systemic significance, between each sub-category resulting in a linear increase in the requirement of additional Common Equity Tier 1 capital, with the exception of the highest sub-category. For the purposes of this paragraph, systemic significance is the expected impact exerted by the G-SII's distress on the global financial market. The lowest sub-category shall be assigned a G-SII buffer of 1 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013 and the buffer assigned to each sub-category shall increase in gradients of 0,5 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013 up to and including the fourth sub-category. The highest sub-category of the G-SII buffer shall be subject to a buffer of 3,5 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013.

10. Without prejudice to paragraphs 1 and 9, the competent authority or the designated authority may, in the exercise of sound supervisory judgment:

- (a) re-allocate a G-SII from a lower sub-category to a higher sub-category;
- (b) allocate an entity as referred to in paragraph 1 that has an overall score that is lower than the cut-off score of the lowest sub-category to that sub-category or to a higher sub-category, thereby designating it as a G-SII.

11. Where the competent authority or the designated authority takes a decision in accordance with paragraph 10(b), it shall notify EBA accordingly, providing reasons.

12. The competent authority or the designated authority shall notify the names of the G-SIIs and O-SIIs and the respective sub-category to which each G-SII is allocated, to the Commission, the ESRB and EBA, and shall disclose their names to the public. The competent authorities or designated authorities shall disclose to the public the sub-category to which each G-SII is allocated.



The competent authority or the designated authority shall review annually the identification of G-SIIs and O-SIIs and the G-SII allocation into the respective sub-categories and report the result to the systemically important institution concerned, to the Commission, the ESRB and EBA and disclose the updated list of identified systemically important institutions to the public and shall disclose to the public the sub-category into which each identified G-SII is allocated.

13. Systemically important institutions shall not use Common Equity Tier 1 capital that is maintained to meet the requirements under paragraphs 4 and 5 to meet any requirements imposed under Article 92 of Regulation (EU) No 575/2013 and Articles 129 and 130 of this Directive and any requirements imposed under Articles 102 and 104 of this Directive.

14. Where a group, on a consolidated basis, is subject to the following, the higher buffer shall apply in each case:

- (a) a G-SII buffer and an O-SII buffer;
- (b) a G-SII buffer, an O-SII buffer and a systemic risk buffer in accordance with Article 133.

Where an institution, on an individual or sub-consolidated basis is subject to an O-SII buffer and a systemic risk buffer in accordance with Article 133, the higher of the two shall apply.

15. Notwithstanding paragraph 14, where the systemic risk buffer applies to all exposures located in the Member State that sets that buffer to address the macroprudential risk of that Member State, but does not apply to exposures outside the Member State, that systemic risk buffer shall be cumulative with the O-SII or G-SII buffer that is applied in accordance with this Article.

16. Where paragraph 14 applies and an institution is part of a group or a sub-group to which a G-SII or an O-SII belongs, this shall never imply that that institution is, on an individual basis, subject to a combined buffer requirement that is lower than the sum of the capital conservation buffer, the counter-cyclical capital buffer, and the higher of the O-SII buffer and systemic risk buffer applicable to it on an individual basis.

17. Where paragraph 15 applies and an institution is part of a group or a sub-group to which a G-SII or an O-SII belongs, this shall never imply that that institution is, on an individual basis, subject to a combined buffer requirement that is lower

than the sum of the capital conservation buffer, the counter-cyclical capital buffer, and the sum of the O-SII buffer and systemic risk buffer applicable to it on an individual basis.

18. EBA shall develop draft regulatory technical standards to specify, for the purposes of this Article, the methodology in accordance with which the competent authority or the designated authority shall identify an EU parent institution or EU parent financial holding company or EU parent mixed financial holding company as a G-SII and to specify the methodology for the definition of the sub-categories and the allocation of G-SIIs in sub-categories based on their systemic significance, taking into account any internationally agreed standards.

EBA shall submit those draft regulatory technical standards to the Commission by 30 June 2014.

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

#### Article 132

#### Reporting

1. The Commission shall, by 31 December 2015, submit a report to the European Parliament and to the Council on the basis of international developments and EBA opinion on the possibility of extending the framework for G-SIIs to additional types of systemically important institutions within the Union, accompanied by a legislative proposal where appropriate.

2. The Commission shall, by 31 December 2016, after consulting the ESRB and EBA, submit a report to the European Parliament and to the Council on whether the provisions relating to G-SIIs as set out in Article 131 should be amended, accompanied by a legislative proposal where appropriate. Any such proposal shall take due account of international regulatory developments and shall review, where appropriate, the process of allocating institution-specific O-SII buffers within a group taking into consideration any possible undue impact on the implementation of structural separation within Member States.

#### Article 133

#### Requirement to maintain a systemic risk buffer

1. Each Member State may introduce a systemic risk buffer of Common Equity Tier 1 capital for the financial sector or one or more subsets of that sector, in order to prevent and mitigate long term non-cyclical systemic or macroprudential risks not covered by Regulation (EU) No 575/2013, 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.

2. For the purpose of paragraph 1, the Member State shall designate the authority in charge of setting the systemic risk buffer and of identifying the sets of institutions to which it applies. This authority shall be the competent authority or the designated authority.

3. For the purpose of paragraph 1, institutions may be required to maintain, in addition to the Common Equity Tier 1 capital maintained to meet the own funds requirement imposed by Article 92 of Regulation (EU) No 575/2013, a systemic risk buffer of Common Equity Tier 1 capital of at least 1 % based on the exposures to which the systemic risk buffer applies in accordance with paragraph 8 of this Article, on an individual, consolidated, or sub-consolidated basis, as applicable in accordance with Part One, Title II of that Regulation. The relevant competent or designated authority may require institutions to maintain the systemic risk buffer on an individual and on a consolidated level.

4. Institutions shall not use Common Equity Tier 1 capital that is maintained to meet the requirement under paragraph 3 to meet any requirements imposed under Article 92 of Regulation (EU) No 575/2013 and Articles 129 and 130 of this Directive and any requirements imposed under Articles 102 and 104 of this Directive. Where a group which has been identified as a systemically important institution which is subject to a G-SII buffer or an O-SII buffer on a consolidated basis in accordance with Article 131 is also subject to a systemic risk buffer on a consolidated basis in accordance with this Article, the higher of the buffers shall apply. Where an institution, on an individual or sub-consolidated basis, is subject to an O-SII buffer in accordance with Article 131 and a systemic risk buffer in accordance with this Article, the higher of the two shall apply.

5. Notwithstanding paragraph 4, where the systemic risk buffer applies to all exposures located in the Member State that sets that buffer to address the macroprudential risk of that Member State, but does not apply to exposures outside the Member State, that systemic risk buffer shall be cumulative with the O-SII or G-SII buffer that is applied in accordance with Article 131.

6. Where paragraph 4 applies and an institution is part of a group or a sub-group to which a G-SII or an O-SII belongs, this shall never imply that that institution is, on an individual basis, subject to a combined buffer requirement that is lower than the sum of the capital conservation buffer, the countercyclical capital buffer, and the higher of the O-SII buffer and systemic risk buffer applicable to it on an individual basis.

7. Where paragraph 5 applies and an institution is part of a group or a sub-group to which a G-SII or an O-SII belongs, this shall never imply that that institution is, on an individual basis, subject to a combined buffer requirement that is lower than the

sum of the capital conservation buffer, the countercyclical capital buffer and the sum of the O-SII buffer and systemic risk buffer applicable to it on an individual basis.

8. The systemic risk buffer may apply to exposures located in the Member State that sets that buffer and may also apply to exposures in third countries. The systemic risk buffer may also apply to exposures located in other Member States, subject to paragraphs 15 and 18.

9. The systemic risk buffer shall apply to all institutions, or one or more subsets of those institutions, for which the authorities of the Member State concerned are competent in accordance with this Directive and shall be set in gradual or accelerated steps of adjustment of 0,5 percentage point. Different requirements may be introduced for different subsets of the sector.

10. When requiring a systemic risk buffer to be maintained the competent authority or the designated authority shall comply with the following:

- (a) the systemic risk buffer must not entail disproportionate adverse effects on the whole or parts of the financial system of other Member States or of the Union as a whole forming or creating an obstacle to the functioning of the internal market;
- (b) the systemic risk buffer must be reviewed by the competent authority or the designated authority at least every second year.

11. Before setting or resetting a systemic risk buffer rate of up to 3 %, the competent authority or the designated authority shall notify the Commission, the ESRB, EBA and the competent and designated authorities of the Member States concerned one month before the publication of the decision referred to in paragraph 16. If the buffer applies to exposures located in third countries the competent authority or the designated authority shall also notify the supervisory authorities of those third-countries. That notification shall describe in detail:

- (a) the systemic or macroprudential risk in the Member State;
- (b) the reasons why the dimension of the systemic or macroprudential risks threatens the stability of the financial system at national level justifying the systemic risk buffer rate;
- (c) the justification for why the systemic risk buffer is considered likely to be effective and proportionate to mitigate the risk;

(d) an assessment of the likely positive or negative impact of the systemic risk buffer on the internal market, based on information which is available to the Member State;

(e) the justification for why none of the existing measures in this Directive or in Regulation (EU) No 575/2013, excluding Articles 458 and 459 of that Regulation, alone or in combination, will be sufficient to address the identified macroprudential or systemic risk taking into account the relative effectiveness of those measures;

(f) the systemic risk buffer rate that the Member State wishes to require.

12. Before setting or resetting a systemic risk buffer rate of above 3 %, the competent authority or the designated authority shall notify the Commission, the ESRB, EBA and the competent and designated authorities of the Member States concerned. If the buffer applies to exposures located in third-countries the competent authority or the designated authority shall also notify the supervisory authorities of those third-countries. That notification shall describe in detail:

(a) the systemic or macroprudential risk in the Member State;

(b) the reasons why the dimension of the systemic or macroprudential risks threatens the stability of the financial system at national level justifying the systemic risk buffer rate;

(c) the justification for why the systemic risk buffer is considered likely to be effective and proportionate to mitigate the risk;

(d) an assessment of the likely positive or negative impact of the systemic risk buffer on the internal market, based on information which is available to the Member State;

(e) the justification for why none of the existing measures in this Directive or in Regulation (EU) No 575/2013, excluding Articles 458 and 459 of that Regulation, alone or in combination, will be sufficient to address the identified macroprudential or systemic risk taking into account the relative effectiveness of those measures;

(f) the systemic risk buffer rate that the Member State wishes to require.

13. The competent authority or the designated authority may from 1 January 2015 set or reset a systemic risk buffer rate that applies to exposures located in that Member State and may also apply to exposures in third countries of up to 5 % and follow

the procedures set out in paragraph 11. When setting or resetting a systemic risk buffer rate above 5 % the procedures set out in paragraph 12 shall be complied with.

14. Where the systemic risk buffer rate is to be set between 3 % and 5 % in accordance with paragraph 13, the competent authority or the designated authority of the Member State that sets that buffer shall always notify the Commission thereof and shall await the opinion of the Commission before adopting the measures in question.

Where the opinion of the Commission is negative, the competent authority or the designated authority of the Member State that sets that buffer shall comply with that opinion or give reasons for not so doing.

Where one subset of the financial sector is a subsidiary whose parent is established in another Member State, the competent authority or the designated authority shall notify the authorities of that Member State, the Commission and the ESRB. Within one month of the notification, the Commission and the ESRB shall issue a recommendation on the measures taken in accordance with this paragraph. Where the authorities disagree and in the case of a negative recommendation of both the Commission and the ESRB, the competent authority or the designated authority may refer the matter to EBA and request its assistance in accordance with Article 19 of Regulation (EU) No 1093/2010. The decision to set the buffer for those exposures shall be suspended until EBA has taken a decision.

15. Within one month of the notification referred to in paragraph 12, the ESRB shall provide the Commission with an opinion as to whether the systemic risk buffer is deemed appropriate. EBA may also provide the Commission with its opinion on the buffer in accordance with Article 34(1) of Regulation (EU) No 1093/2010.

Within two months of notification, the Commission, taking into account the assessment of the ESRB and EBA, if relevant, and if it is satisfied that the systemic risk buffer does not entail disproportionate adverse effects on the whole or parts of the financial system of other Member States or of the Union as a whole forming or creating an obstacle to the proper functioning of the internal market, shall adopt an implementing act authorising the competent authority or the designated authority to adopt the proposed measure.

16. Each competent authority or designated authority shall announce the setting of the systemic risk buffer by publication on an appropriate website. The announcement shall include at least the following information:

(a) the systemic risk buffer rate;

- (b) the institutions to which the systemic risk buffer applies;
- (c) a justification for the systemic risk buffer;
- (d) the date from which the institutions must apply the setting or resetting of the systemic risk buffer; and
- (e) the names of the countries where exposures located in those countries are recognised in the systemic risk buffer.

If the publication referred to in point (c) could jeopardise the stability of the financial system, the information under point (c) shall not be included in the announcement.

17. Where an institution fails to meet fully the requirement under paragraph 1 of this Article, it shall be subject to the restrictions on distributions set out in Article 141(2) and (3).

Where the application of those restrictions on distributions leads to an unsatisfactory improvement of the Common Equity Tier 1 capital of the institution in the light of the relevant systemic risk, the competent authorities may take additional measures in accordance with Article 64.

18. Following notification as referred to in paragraph 11, Member States may apply the buffer to all exposures. Where the competent authority or the designated authority decides to set the buffer up to 3% on the basis of exposures in other Member States, the buffer shall be set equally on all exposures located within the Union.

#### Article 134

##### Recognition of a systemic risk buffer rate

1. Other Member States may recognise the systemic risk buffer rate set in accordance with Article 133 and may apply that buffer rate to domestically authorised institutions for the exposures located in the Member State that sets that buffer rate.
2. If Member States recognise the systemic risk buffer rate for domestically authorised institutions they shall notify the Commission, the ESRB, EBA and the Member State that sets that systemic risk buffer rate.
3. When deciding whether to recognise a systemic risk buffer rate, the Member State shall take into consideration the information presented by the Member State that sets that buffer rate in accordance with Article 133(11), (12) or (13).
4. A Member State that sets a systemic risk buffer rate in accordance with Article 133 may ask the ESRB to issue a

recommendation as referred to in Article 16 of Regulation (EU) No 1092/2010 to one or more Member States which may recognise the systemic risk buffer rate.

#### Section II

##### Setting and calculating countercyclical capital buffers

#### Article 135

##### ESRB guidance on setting countercyclical buffer rates

1. The ESRB may give, by way of recommendations in accordance with Article 16 of Regulation (EU) No 1092/2010, guidance to authorities designated by Member States under Article 136(1) on setting countercyclical buffer rates, including the following:

- (a) principles to guide designated authorities when exercising their judgment as to the appropriate countercyclical buffer rate, ensure that authorities adopt a sound approach to relevant macro-economic cycles and promote sound and consistent decision-making across Member States;
- (b) general guidance on:
  - (i) the measurement and calculation of the deviation from long term trends of ratios of credit to gross domestic product (GDP);
  - (ii) the calculation of buffer guides required by Article 136(2);
- (c) guidance on variables that indicate the build-up of system-wide risk associated with periods of excessive credit growth in a financial system, in particular the relevant credit-to-GDP ratio and its deviation from the long-term trend, and on other relevant factors, including the treatment of economic developments within individual sectors of the economy, that should inform the decisions of designated authorities on the appropriate countercyclical buffer rate under Article 136;
- (d) guidance on variables, including qualitative criteria, that indicate that the buffer should be maintained, reduced or fully released.

2. Where it issues a recommendation under paragraph 1, the ESRB shall duly take into account the differences between Member States and in particular the specificities of Member States with small and open economies.

3. Where it has issued a recommendation under paragraph 1, the ESRB shall keep it under review and update it, where necessary, in the light of experience of setting buffers under this Directive or of developments in internationally agreed practices.



## Article 136

**Setting countercyclical buffer rates**

1. Each Member State shall designate a public authority or body (a 'designated authority') that is responsible for setting the countercyclical buffer rate for that Member State.

2. Each designated authority shall calculate for every quarter a buffer guide as a reference to guide its exercise of judgment in setting the countercyclical buffer rate in accordance with paragraph 3. The buffer guide shall reflect, in a meaningful way, the credit cycle and the risks due to excess credit growth in the Member State and shall duly take into account specificities of the national economy. It shall be based on the deviation of the ratio of credit-to-GDP from its long-term trend, taking into account, *inter alia*:

- (a) an indicator of growth of levels of credit within that jurisdiction and, in particular, an indicator reflective of the changes in the ratio of credit granted in that Member State to GDP;
- (b) any current guidance maintained by the ESRB in accordance with Article 135(1)(b).

3. Each designated authority shall assess and set the appropriate countercyclical buffer rate for its Member State on a quarterly basis, and in so doing shall take into account:

- (a) the buffer guide calculated in accordance with paragraph 2;
- (b) any current guidance maintained by the ESRB in accordance with Article 135(1)(a), (c) and (d) and any recommendations issued by the ESRB on the setting of a buffer rate;
- (c) other variables that the designated authority considers relevant for addressing cyclical systemic risk.

4. The countercyclical buffer rate, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013 of institutions that have credit exposures in that Member State, shall be between 0 % and 2,5 %, calibrated in steps of 0,25 percentage points or multiples of 0,25 percentage points. Where justified on the basis of the considerations set out in paragraph 3, a designated authority may set a countercyclical buffer rate in excess of 2,5 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013 for the purpose set out in Article 140(2) of this Directive.

5. Where a designated authority sets the countercyclical buffer rate above zero for the first time, or where, thereafter,

a designated authority increases the prevailing countercyclical buffer rate setting, it shall also decide the date from which the institutions must apply that increased buffer for the purposes of calculating their institution-specific countercyclical capital buffer. That date shall be no later than 12 months after the date when the increased buffer setting is announced in accordance with paragraph 7. If the date is less than 12 months after the increased buffer setting is announced, that shorter deadline for application shall be justified on the basis of exceptional circumstances.

6. If a designated authority reduces the existing countercyclical buffer rate, whether or not it is reduced to zero, it shall also decide an indicative period during which no increase in the buffer is expected. However, that indicative period shall not bind the designated authority.

7. Each designated authority shall announce the quarterly setting of the countercyclical buffer rate by publication on its website. The announcement shall include at least the following information:

- (a) the applicable countercyclical buffer rate;
- (b) the relevant credit-to-GDP-ratio and its deviation from the long-term trend;
- (c) the buffer guide calculated in accordance with paragraph 2;
- (d) a justification for that buffer rate;
- (e) where the buffer rate is increased, the date from which the institutions must apply that increased buffer rate for the purposes of calculating their institution-specific countercyclical capital buffer;
- (f) where the date referred to in point (e) is less than 12 months after the date of the announcement under this paragraph, a reference to the exceptional circumstances that justify that shorter deadline for application;
- (g) where the buffer rate is decreased, the indicative period during which no increase in the buffer rate is expected, together with a justification for that period;

Designated authorities shall take all reasonable steps to coordinate the timing of that announcement.

Designated authorities shall notify each quarterly setting of the countercyclical buffer rate and the information specified in points (a) to (g) to the ESRB. The ESRB shall publish on its website all such notified buffer rates and related information.



*Article 137***Recognition of countercyclical buffer rates in excess of 2,5 %**

1. Where a designated authority, in accordance with Article 136(4), or a relevant third-country authority has set a countercyclical buffer rate in excess of 2,5 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, the other designated authorities may recognise that buffer rate for the purposes of the calculation by domestically authorised institutions of their institution-specific countercyclical capital buffers.

2. Where a designated authority in accordance with paragraph 1 of this Article recognises a buffer rate in excess of 2,5 % of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, it shall announce that recognition by publication on its website. The announcement shall include at least the following information:

- (a) the applicable countercyclical buffer rate;
- (b) the Member State or third countries to which it applies;
- (c) where the buffer rate is increased, the date from which the institutions authorised in the Member State of the designated authority must apply that increased buffer rate for the purposes of calculating their institution-specific countercyclical capital buffer;
- (d) where the date referred to in point (c) is less than 12 months after the date of the announcement under this paragraph, a reference to the exceptional circumstances that justify that shorter deadline for application.

*Article 138***ESRB recommendation on third country countercyclical buffer rates**

The ESRB may, in accordance with Article 16 of Regulation (EU) No 1092/2010, issue a recommendation to designated authorities on the appropriate countercyclical buffer rate for exposures to that third country where:

- (a) a countercyclical buffer rate has not been set and published by the relevant third-country authority for a third country ('relevant third-country authority') to which one or more Union institutions have credit exposures;
- (b) the ESRB considers that a countercyclical buffer rate which has been set and published by the relevant third-country authority for a third country is not sufficient to protect

Union institutions appropriately from the risks of excessive credit growth in that country, or a designated authority notifies the ESRB that it considers that buffer rate to be insufficient for that purpose.

*Article 139***Decision by designated authorities on third country countercyclical buffer rates**

1. This Article applies irrespective of whether the ESRB has issued a recommendation to designated authorities as referred to in Article 138.

2. In the circumstances referred to in point (a) of Article 138, designated authorities may set the countercyclical buffer rate that domestically authorised institutions must apply for the purposes of the calculation of their institution-specific countercyclical capital buffer.

3. Where a countercyclical buffer rate has been set and published by the relevant third-country authority for a third country, a designated authority may set a different buffer rate for that third country for the purposes of the calculation by domestically authorised institutions of their institution-specific countercyclical capital buffer if they reasonably consider that the buffer rate set by the relevant third-country authority is not sufficient to protect those institutions appropriately from the risks of excessive credit growth in that country.

When exercising the power under the first subparagraph, a designated authority shall not set a countercyclical buffer rate below the level set by the relevant third-country authority unless that buffer rate exceeds 2,5 %, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013 of institutions that have credit exposures in that third country.

In order to achieve coherence for the buffer settings for third countries the ESRB may give recommendations for such settings.

4. Where a designated authority sets a countercyclical buffer rate for a third country pursuant to paragraph 2 or 3 which increases the existing applicable countercyclical buffer rate, the designated authority shall decide the date from which domestically authorised institutions must apply that buffer rate for the purposes of calculating their institution-specific countercyclical capital buffer. That date shall be no later than 12 months from the date when the buffer rate is announced in accordance with paragraph 5. If that date is less than 12 months after the setting is announced, that shorter deadline for application shall be justified on the basis of exceptional circumstances.

5. Designated authorities shall publish any setting of a countercyclical buffer rate for a third country pursuant to paragraph 2 or 3 on their websites, and shall include the following information:

- (a) the countercyclical buffer rate and the third country to which it applies;
- (b) a justification for that buffer rate;
- (c) where the buffer rate is set above zero for the first time or is increased, the date from which the institutions must apply that increased buffer rate for the purposes of calculating their institution-specific countercyclical capital buffer;
- (d) where the date referred to in point (c) is less than 12 months after the date of the publication of the setting under this paragraph, a reference to the exceptional circumstances that justify that shorter deadline for application.

#### Article 140

#### Calculation of institution-specific countercyclical capital buffer rates

1. The institution-specific countercyclical capital buffer rate shall consist of the weighted average of the countercyclical buffer rates that apply in the jurisdictions where the relevant credit exposures of the institution are located or are applied for the purposes of this Article by virtue of Article 139(2) or (3).

Member States shall require institutions, in order to calculate the weighted average referred to in the first subparagraph, to apply to each applicable countercyclical buffer rate its total own funds requirements for credit risk, determined in accordance with Part Three, Titles II and IV of Regulation (EU) No 575/2013, that relates to the relevant credit exposures in the territory in question, divided by its total own funds requirements for credit risk that relates to all of its relevant credit exposures.

2. If, in accordance with Article 136(4), a designated authority sets a countercyclical buffer rate in excess of 2,5 % of total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, Member States shall ensure that the following buffer rates apply to relevant credit exposures located in the Member State of that designated authority ('Member State A') for the purposes of the calculation required under paragraph 1 including, where relevant, for the purposes of the calculation of the element of consolidated capital that relates to the institution in question:

- (a) domestically authorised institutions shall apply that buffer rate in excess of 2,5 % of total risk exposure amount;

- (b) institutions that are authorised in another Member State shall apply a countercyclical buffer rate of 2,5 % of total risk exposure amount if the designated authority in the Member State in which they have been authorised has not recognised the buffer rate in excess of 2,5 % in accordance with Article 137(1);

- (c) institutions that are authorised in another Member State shall apply the countercyclical buffer rate set by the designated authority of Member State A if the designated authority in the Member State in which they have been authorised has recognised the buffer rate in accordance with Article 137.

3. If the countercyclical buffer rate set by the relevant third-country authority for a third country exceeds 2,5 % of total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, Member States shall ensure that the following buffer rates apply to relevant credit exposures located in that third country for the purposes of the calculation required under paragraph 1 including, where relevant, for the purposes of the calculation of the element of consolidated capital that relates to the institution in question:

- (a) institutions shall apply a countercyclical buffer rate of 2,5 % of total risk exposure amount if the designated authority in the Member State in which they have been authorised has not recognised the buffer rate in excess of 2,5 % in accordance with Article 137(1);

- (b) institutions shall apply the countercyclical buffer rate set by the relevant third-country authority if the designated authority in the Member State in which they have been authorised has recognised the buffer rate in accordance with Article 137.

4. Relevant credit exposures shall include all those exposure classes, other than those referred to in points (a) to (f) of Article 112 of Regulation (EU) No 575/2013, that are subject to:

- (a) the own funds requirements for credit risk under Part Three, Title II of that Regulation;

- (b) where the exposure is held in the trading book, own funds requirements for specific risk under Part Three, Title IV, Chapter 2 of that Regulation or incremental default and migration risk under Part Three, Title IV, Chapter 5 of that Regulation;

- (c) where the exposure is a securitisation, the own funds requirements under Part Three, Title II, Chapter 5 of that Regulation.

5. Institutions shall identify the geographical location of a relevant credit exposure in accordance with regulatory technical standards adopted in accordance with paragraph 7.

6. For the purposes of the calculation required under paragraph 1:

- (a) a countercyclical buffer rate for a Member State shall apply from the date specified in the information published in accordance with Article 136(7)(e) or Article 137(2)(c) if the effect of that decision is to increase the buffer rate;
- (b) subject to point (c), a countercyclical buffer rate for a third country shall apply 12 months after the date on which a change in the buffer rate was announced by the relevant third-country authority, irrespective of whether that authority requires institutions incorporated in that third country to apply the change within a shorter period, if the effect of that decision is to increase the buffer rate;
- (c) where the designated authority of the home Member State of the institution sets the countercyclical buffer rate for a third country pursuant to Article 139(2) or (3), or recognises the countercyclical buffer rate for a third country pursuant to Article 137, that buffer rate shall apply from the date specified in the information published in accordance with Article 139(5)(c) or Article 137(2)(c), if the effect of that decision is to increase the buffer rate;
- (d) a countercyclical buffer rate shall apply immediately if the effect of that decision is to reduce the buffer rate.

For the purposes of point (b), a change in the countercyclical buffer rate for a third country shall be considered to be announced on the date that it is published by the relevant third-country authority in accordance with the applicable national rules.

7. EBA shall develop draft regulatory technical standards to specify the method for the identification of the geographical location of the relevant credit exposures referred to in paragraph 5.

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

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

### Section III

## Capital conservation measures

### Article 141

#### Restrictions on distributions

1. Member States shall prohibit any institution that meets the combined buffer requirement from making a distribution in connection with Common Equity Tier 1 capital to an extent that would decrease its Common Equity Tier 1 capital to a level where the combined buffer requirement is no longer met.

2. Member States shall require institutions that fail to meet the combined buffer requirement to calculate the Maximum Distributable Amount ('MDA') in accordance with paragraph 4 and to notify the competent authority of that MDA.

Where the first subparagraph applies, Member States shall prohibit any such institution from undertaking any of the following actions before it has calculated the MDA:

- (a) make a distribution in connection with Common Equity Tier 1 capital;
- (b) create an obligation to pay variable remuneration or discretionary pension benefits or pay variable remuneration if the obligation to pay was created at a time when the institution failed to meet the combined buffer requirements;
- (c) make payments on Additional Tier 1 instruments.

3. While an institution fails to meet or exceed its combined buffer requirement, Member States shall prohibit it from distributing more than the MDA calculated in accordance with paragraph 4 through any action referred to in points (a), (b) and (c) of paragraph 2.

4. Member States shall require institutions to calculate the MDA by multiplying the sum calculated in accordance with paragraph 5 by the factor determined in accordance with paragraph 6. The MDA shall be reduced by any of the actions referred to in point (a), (b) or (c) of the second subparagraph of paragraph 2.

5. The sum to be multiplied in accordance with paragraph 4 shall consist of:

- (a) interim profits not included in Common Equity Tier 1 capital pursuant to Article 26(2) of Regulation (EU) No 575/2013 that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in point (a), (b) or (c) of the second subparagraph of paragraph 2 of this Article;

plus

(b) year-end profits not included in Common Equity Tier 1 capital pursuant to Article 26(2) of Regulation (EU) No 575/2013 that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in point (a), (b) or (c) of the second subparagraph of paragraph 2 of this Article;

minus

(c) amounts which would be payable by tax if the items specified in points (a) and (b) of this paragraph were to be retained.

6. The factor shall be determined as follows:

(a) where the Common Equity Tier 1 capital maintained by the institution which is not used to meet the own funds requirement under Article 92(1)(c) of Regulation (EU) No 575/2013, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of that Regulation, is within the first (that is, the lowest) quartile of the combined buffer requirement, the factor shall be 0;

(b) where the Common Equity Tier 1 capital maintained by the institution which is not used to meet the own funds requirement under Article 92(1)(c) of Regulation (EU) No 575/2013, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of that Regulation, is within the second quartile of the combined buffer requirement, the factor shall be 0,2;

(c) where the Common Equity Tier 1 capital maintained by the institution which is not used to meet the own funds requirement under Article 92(1)(c) of Regulation (EU) No 575/2013, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of that Regulation, is within the third quartile of the combined buffer requirement, the factor shall be 0,4;

(d) where the Common Equity Tier 1 capital maintained by the institution which is not used to meet the own funds requirement under Article 92(1)(c) of Regulation (EU) No 575/2013, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of that Regulation, is within the fourth (that is, the highest) quartile of the combined buffer requirement, the factor shall be 0,6;

The lower and upper bounds of each quartile of the combined buffer requirement shall be calculated as follows:

$$\text{Lower bound of quartile} = \frac{\text{Combined buffer requirement}}{4} \times (Q_n - 1)$$

$$\text{Upper bound of quartile} = \frac{\text{Combined buffer requirement}}{4} \times Q_n$$

"Q<sub>n</sub>" indicates the ordinal number of the quartile concerned.

7. The restrictions imposed by this Article shall only apply to payments that result in a reduction of Common Equity Tier 1 capital or in a reduction of profits, and where a suspension of payment or failure to pay does not constitute an event of default or a condition for the commencement of proceedings under the insolvency regime applicable to the institution.

8. Where an institution fails to meet the combined buffer requirement and intends to distribute any of its distributable profits or undertake an action referred to in points (a), (b) and (c) of the second subparagraph of paragraph 2, it shall notify the competent authority and provide the following information:

(a) the amount of capital maintained by the institution, subdivided as follows:

(i) Common Equity Tier 1 capital,

(ii) Additional Tier 1 capital,

(iii) Tier 2 capital;

(b) the amount of its interim and year-end profits;

(c) the MDA calculated in accordance with paragraph 4;

(d) the amount of distributable profits it intends to allocate between the following:

(i) dividend payments,

(ii) share buybacks,

(iii) payments on Additional Tier 1 instruments,

(iv) the payment of variable remuneration or discretionary pension benefits, whether by creation of a new obligation to pay, or payment pursuant to an obligation to pay created at a time when the institution failed to meet its combined buffer requirements.

9. Institutions shall maintain arrangements to ensure that the amount of distributable profits and the MDA are calculated accurately, and shall be able to demonstrate that accuracy to the competent authority on request.

10. For the purposes of paragraphs 1 and 2, a distribution in connection with Common Equity Tier 1 capital shall include the following:

- (a) a payment of cash dividends;
- (b) a distribution of fully or partly paid bonus shares or other capital instruments referred to in Article 26(1)(a) of Regulation (EU) No 575/2013;
- (c) a redemption or purchase by an institution of its own shares or other capital instruments referred to in Article 26(1)(a) of that Regulation;
- (d) a repayment of amounts paid up in connection with capital instruments referred to in Article 26(1)(a) of that Regulation;
- (e) a distribution of items referred to in points (b) to (e) of Article 26(1) of that Regulation.

#### *Article 142*

##### **Capital Conservation Plan**

1. Where an institution fails to meet its combined buffer requirement, it shall prepare a capital conservation plan and submit it to the competent authority no later than five working days after it identified that it was failing to meet that requirement, unless the competent authority authorises a longer delay up to 10 days.

Competent authorities shall grant such authorisations only on the basis of the individual situation of a credit institution and taking into account the scale and complexity of the institution's activities.

2. The capital conservation plan shall include the following:

- (a) estimates of income and expenditure and a forecast balance sheet;
- (b) measures to increase the capital ratios of the institution;
- (c) a plan and timeframe for the increase of own funds with the objective of meeting fully the combined buffer requirement;

(d) any other information that the competent authority considers to be necessary to carry out the assessment required by paragraph 3.

3. The competent authority shall assess the capital conservation plan, and shall approve the plan only if it considers that the plan, if implemented, would be reasonably likely to conserve or raise sufficient capital to enable the institution to meet its combined buffer requirements within a period which the competent authority considers appropriate.

4. If the competent authority does not approve the capital conservation plan in accordance with paragraph 3, it shall impose one or both of the following:

- (a) require the institution to increase own funds to specified levels within specified periods;
- (b) exercise its powers under Article 102 to impose more stringent restrictions on distributions than those required by Article 141.

#### TITLE VIII

##### **DISCLOSURE BY COMPETENT AUTHORITIES**

#### *Article 143*

##### **General disclosure requirements**

1. Competent authorities shall publish the following information:

- (a) the texts of laws, regulations, administrative rules and general guidance adopted in their Member State in the field of prudential regulation;
- (b) the manner of exercise of the options and discretions available in Union law;
- (c) the general criteria and methodologies they use in the review and evaluation referred to in Article 97;
- (d) without prejudice to the provisions set out in Title VII, Chapter 1, Section II of this Directive and Articles 54 and 58 of Directive 2004/39/EC, aggregate statistical data on key aspects of the implementation of the prudential framework in each Member State, including the number and nature of supervisory measures taken in accordance with Article 102(1)(a) and of administrative penalties imposed in accordance with Article 65.



2. The information published in accordance with paragraph 1 shall be sufficient to enable a meaningful comparison of the approaches adopted by the competent authorities of the different Member States. The disclosures shall be published following a common format and updated regularly. The disclosures shall be accessible at a single electronic location.

3. EBA shall develop draft implementing technical standards to determine the format, structure, contents list and annual publication date of the information listed in paragraph 1.

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 Article 15 of Regulation (EU) No 1093/2010.

#### Article 144

##### Specific disclosure requirements

1. For the purpose of Part Five of Regulation (EU) No 575/2013, competent authorities shall publish the following information:

- (a) the general criteria and methodologies adopted to review compliance with Articles 405 to 409 of Regulation (EU) No 575/2013;
- (b) without prejudice to the provisions laid down in Title VII, Chapter 1, Section II, a summary description of the outcome of the supervisory review and description of the measures imposed in cases of non-compliance with Articles 405 to 409 of Regulation (EU) No 575/2013, identified on an annual basis.

2. The competent authority of a Member State exercising the discretion laid down in Article 7(3) of Regulation (EU) No 575/2013 shall publish the following information:

- (a) the criteria it applies to determine that there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities;
- (b) the number of parent institutions which benefit from the exercise of the discretion laid down in Article 7(3) of Regulation (EU) No 575/2013 and the number of those which incorporate subsidiaries in a third country;
- (c) on an aggregate basis for the Member State:

- (i) the total amount of own funds on the consolidated basis of the parent institution in a Member State, which benefits from the exercise of the discretion laid down in Article 7(3) of Regulation (EU) No 575/2013, which are held in subsidiaries in a third country;

- (ii) the percentage of total own funds on the consolidated basis of parent institutions in a Member State which benefits from the exercise of the discretion laid down in Article 7(3) of that Regulation, represented by own funds which are held in subsidiaries in a third country;

- (iii) the percentage of total own funds required under Article 92 of that Regulation on the consolidated basis of parent institutions in a Member State, which benefits from the exercise of the discretion laid down in Article 7(3) of that Regulation, represented by own funds which are held in subsidiaries in a third country.

3. The competent authority which exercises the discretion laid down in Article 9(1) of Regulation (EU) No 575/2013 shall publish all the following:

- (a) the criteria it applies to determine that there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities;

- (b) the number of parent institutions which benefit from the exercise of the discretion laid down in Article 9(1) of Regulation (EU) No 575/2013 and the number of such parent institutions which incorporate subsidiaries in a third country;

- (c) on an aggregate basis for the Member State:

- (i) the total amount of own funds of parent institutions which benefit from the exercise of the discretion laid down in Article 9(1) of Regulation (EU) No 575/2013 which are held in subsidiaries in a third country;

- (ii) the percentage of total own funds of parent institutions which benefit from the exercise of the discretion laid down in Article 9(1) of Regulation (EU) No 575/2013 represented by own funds which are held in subsidiaries in a third country;

- (iii) the percentage of total own funds required under Article 92 of Regulation (EU) No 575/2013 of parent institutions which benefit from the exercise of the discretion laid down in Article 9(1) of that Regulation represented by own funds which are held in subsidiaries in a third country.

## TITLE IX

**DELEGATED AND IMPLEMENTING ACTS***Article 145***Delegated Acts**

The Commission shall be empowered to adopt delegated acts in accordance with Article 148 concerning the following:

- (a) clarification of the definitions set out in Article 3 and Article 128 to ensure uniform application of this Directive;
- (b) clarification of the definitions set out in Article 3 and Article 128 in order to take account, in the application of this Directive, of developments on financial markets;
- (c) alignment of terminology on, and the framing of, definitions set out in Article 3 in accordance with subsequent acts on institutions and related matters;
- (d) adjustment of the amounts referred to in Article 31(1) to take account of changes in the European Index of Consumer Prices as published by Eurostat, in line with, and at the same time as, the adjustments made under Article 4(7) of Directive 2002/92/EC;
- (e) expansion of the content of the list referred to in Articles 33 and 34 and set out in Annex I or adaptation of the terminology used in that list to take account of developments on financial markets;
- (f) identification of the areas in which the competent authorities must exchange information as set out in Article 50;
- (g) adjustment of the provisions set out in Articles 76 to 88 and Article 98 in order to take account of developments on financial markets (in particular new financial products) or in accounting standards or requirements which take account of Union law, or with regard to the convergence of supervisory practices;
- (h) deferral of the disclosure obligations in accordance with the second subparagraph of Article 89(3) where the Commission report submitted pursuant to the first subparagraph of that paragraph identifies significant negative effects;
- (i) adjustments of the criteria set out in Article 23(1), in order to take account of future developments and to ensure the uniform application of this Directive.

*Article 146***Implementing Acts**

The following measures shall be adopted as implementing acts in accordance with the examination procedure referred to in Article 147(2):

- (a) technical adjustments to the list in Article 2;
- (b) alteration of the amount of initial capital prescribed in Article 12 and Title IV to take account of developments in the economic and monetary field.

*Article 147***European Banking Committee**

1. For the adoption of implementing acts, the Commission shall be assisted by the European Banking Committee. 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.

*Article 148***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 power referred to in Article 145 shall be conferred for an indeterminate period of time from 17 July 2013.

3. The delegation of powers referred to in Article 145 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 any 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 Article 145 shall enter into force only if no objection has been expressed either by the European Parliament or the Council within a period of three 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 three months at the initiative of the European Parliament or the Council.

#### Article 149

### Objections to regulatory technical standards

Where the Commission adopts a regulatory technical standard pursuant to this Directive which is the same as the draft regulatory technical standard submitted by EBA, the period during which the European Parliament and the Council may object to that regulatory technical standard shall be one month from the date of notification. At the initiative of the European Parliament or the Council that period shall be extended by one month. By way of derogation from the second subparagraph of Article 13(1) of Regulation (EU) No 1093/2010, the period during which the European Parliament or the Council may object to that regulatory technical standard may, where appropriate, be further extended by one month.

#### TITLE X

### AMENDMENTS OF DIRECTIVE 2002/87/EC

#### Article 150

### Amendments of Directive 2002/87/EC

Article 21a of Directive 2002/87/EC is hereby amended as follows:

- (a) in paragraph 2, point (a) is deleted;
- (b) paragraph 3 is replaced by the following:

"3. In order to ensure consistent application of the calculation methods listed in Annex I, Part II, of this Directive, in conjunction with Article 49(1) of Regulation (EU) No 575/2013 and Article 228(1) of Directive 2009/138/EC, but without prejudice to Article 6(4) of this Directive, the ESAs shall, through the Joint Committee, develop draft regulatory technical standards with regard to Article 6(2) of this Directive.

The ESA shall submit those draft regulatory technical standards to the Commission by five months before the date of application referred to in Article 309(1) of Directive 2009/138/EC.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of

Regulation (EU) No 1093/2010, of Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 respectively."

#### TITLE XI

### TRANSITIONAL AND FINAL PROVISIONS

#### CHAPTER 1

### *Transitional provisions on the supervision of institutions exercising the freedom of establishment and the freedom to provide services*

#### Article 151

### Scope

1. The provisions in this Chapter shall apply instead of Articles 40, 41, 43, 49, 50 and 51 until the date on which the liquidity coverage requirement becomes applicable in accordance with a delegated act adopted pursuant to Article 460 of Regulation (EU) No 575/2013.

2. In order to ensure that the phasing in of supervisory arrangements for liquidity is fully aligned with the development of uniform liquidity rules, the Commission shall be empowered to adopt delegated acts in accordance with Article 145 postponing the date referred to in paragraph 1 by up to two years, where uniform liquidity rules have not been introduced in the Union because international standards on liquidity supervision have not yet been agreed upon at the date referred to in paragraph 1 of this Article.

#### Article 152

### Reporting requirements

Host Member States may, for statistical purposes, require that all credit institutions having branches within their territories shall report periodically on their activities in those host Member States to the competent authorities of those host Member States.

In discharging the responsibilities imposed on them in Article 156 of this Directive, host Member States may require that branches of credit institutions from other Member States provide the same information as they require from national credit institutions for that purpose.

#### Article 153

### Measures taken by the competent authorities of the home Member State in relation to activities carried out in the host Member State

1. Where the competent authorities of a host Member State ascertain that a credit institution having a branch or providing services within its territory is not complying with the legal provisions adopted in that Member State pursuant to this Directive involving powers of the host Member State's competent authorities, those authorities shall require the credit institution concerned to remedy its non-compliance.

2. If the credit institution concerned fails to take the necessary steps, the competent authorities of the host Member State shall inform the competent authorities of the home Member State accordingly.

3. The competent authorities of the home Member State shall, at the earliest opportunity, take all appropriate measures to ensure that the credit institution concerned remedies its non-compliance. The nature of those measures shall be communicated to the competent authorities of the host Member State.

4. If, despite the measures taken by the home Member State or because such measures prove inadequate or are not provided for in the Member State in question, the credit institution persists in violating the legal rules referred to in paragraph 1 in force in the host Member State, the latter may, after informing the competent authorities of the home Member State, take appropriate measures to prevent or to punish further breaches and, in so far as is necessary, to prevent that credit institution from initiating further transactions within its territory. Member States shall ensure that it is possible to serve the legal documents necessary for those measures on credit institutions within their territories.

#### Article 154

##### Precautionary measures

Before following the procedure provided for in Article 153, the competent authorities of the host Member State may, in emergencies, take any precautionary measures necessary to protect the interests of depositors, investors and others to whom services are provided. The Commission and the competent authorities of the other Member States concerned shall be informed of such measures at the earliest opportunity.

The Commission may, after consulting the competent authorities of the Member States concerned, decide that the Member State in question shall amend or abolish those measures.

#### Article 155

##### Responsibility

1. The prudential supervision of an institution, including that of the activities it carries out in accordance with Articles 33 and 34, shall be the responsibility of the competent authorities of the home Member State, without prejudice to those provisions of this Directive which give responsibility to the competent authorities of the host Member State.

2. Paragraph 1 shall not prevent supervision on a consolidated basis pursuant to this Directive.

3. The competent authorities in one Member State shall, in the exercise of their general duties, duly consider the potential

impact of their decisions on the stability of the financial system in all other Member States concerned and, in particular, in emergency situations, based on the information available at the relevant time.

#### Article 156

##### Liquidity supervision

Host Member States shall, pending further coordination, retain responsibility in cooperation with the competent authorities of the home Member State for the supervision of the liquidity of the branches of credit institutions.

Without prejudice to the measures necessary for the reinforcement of the European Monetary System, host Member States shall retain complete responsibility for the measures resulting from the implementation of their monetary policies.

Such measures shall not provide for discriminatory or restrictive treatment based on the fact that a credit institution is authorised in another Member State.

#### Article 157

##### Collaboration concerning supervision

The competent authorities of the Member States concerned shall collaborate closely in order to supervise the activities of institutions operating, in particular through a branch, in one or more Member States other than that in which their head offices are situated. They shall supply one another with all information concerning the management and ownership of such institutions that is likely to facilitate their supervision and the examination of the conditions for their authorisation, and all information likely to facilitate the monitoring of such institutions, in particular with regard to liquidity, solvency, deposit guarantees, the limiting of large exposures, administrative and accounting procedures and internal control mechanisms.

#### Article 158

##### Significant branches

1. The competent authorities of a host Member State may make a request to the consolidating supervisor where Article 112(1) applies or to the competent authorities of the home Member State, for a branch of an institution other than an investment firm subject to Article 95 of Regulation (EU) No 575/2013 to be considered as significant.

2. That request shall provide reasons for considering the branch to be significant with particular regard to the following:

(a) whether the market share of the branch in terms of deposits exceeds 2 % in the host Member State;

- (b) the likely impact of a suspension or closure of the operations of the institution on systemic liquidity and the payment, clearing and settlement systems in the host Member State;
- (c) the size and the importance of the branch in terms of number of clients within the context of the banking or financial system of the host Member State.

The competent authorities of the home and host Member States, and the consolidating supervisor where Article 112(1) applies, shall do everything within their power to reach a joint decision on the designation of a branch as being significant.

If no joint decision is reached within two months of receipt of a request under the first subparagraph, the competent authorities of the host Member State shall take their own decision within a further period of two months on whether the branch is significant. In taking their decision, the competent authorities of the host Member State shall take into account any views and reservations of the consolidating supervisor or the competent authorities of the home Member State.

The decisions referred to in the second and third subparagraphs shall be set out in a document containing full reasons, shall be transmitted to the competent authorities concerned, and shall be recognised as determinative and applied by the competent authorities of the Member States concerned.

The designation of a branch as being significant shall not affect the rights and responsibilities of the competent authorities under this Directive.

3. The competent authorities of the home Member State shall communicate to the competent authorities of a host Member State where a significant branch is established the information referred to in Article 117(1)(c) and (d) and carry out the tasks referred to in Article 112(1)(c) in cooperation with the competent authorities of the host Member State.

4. If a competent authority of a home Member State becomes aware of an emergency situation as referred to in Article 114(1), it shall alert as soon as practicable the authorities referred to in Article 58(4) and in Article 59(1).

5. Where Article 116 does not apply, the competent authorities supervising a institution with significant branches in other Member States shall establish and chair a college of supervisors to facilitate the reaching of a joint decision on the designation of a branch as being significant under paragraph 2 of

this Article and the exchange of information under Article 60. The establishment and functioning of the college shall be based on written arrangements determined, after consulting the competent authorities concerned, by the competent authority of the home Member State. The competent authority of the home Member State shall decide which competent authorities participate in a meeting or in an activity of the college.

6. The decision of the competent authority of the home Member State shall take account of the relevance of the supervisory activity to be planned or coordinated for those authorities, in particular the potential impact on the stability of the financial system in the Member States concerned referred to in Article 155(3) and the obligations referred to in paragraph 2 of this Article.

7. The competent authority of the home Member State shall keep all members of the college fully informed, in advance, of the organisation of such meetings, the main issues to be discussed and the activities to be considered. The competent authority of the home Member State shall also keep all the members of the college fully informed, in a timely manner, of the actions taken in those meetings or the measures carried out.

#### Article 159

##### **On-the-spot checks**

1. Host Member States shall provide that, where an institution authorised in another Member State carries out its activities through a branch, the competent authorities of the home Member State may, after having informed the competent authorities of the host Member State, carry out themselves or through an intermediary on-the-spot checks of the information referred to in Article 50.

2. The competent authorities of the home Member State may also, for the purposes of such on-the-spot checking of branches, have recourse to one of the other procedures set out in Article 118.

3. Paragraphs 1 and 2 shall not affect the right of the competent authorities of the host Member State to carry out, in the discharge of their responsibilities under this Directive, on-the-spot checks of branches established within their territory.

#### CHAPTER 2

##### **Transitional provisions for capital buffers**

#### Article 160

##### **Transitional provisions for capital buffers**

1. This Article amends the requirements of Articles 129 and 130 for a transitional period between 1 January 2016 and 31 December 2018.



2. For the period from 1 January 2016 until 31 December 2016:

- (a) the capital conservation buffer shall consist of Common Equity Tier 1 capital equal to 0,625 % of the total of the risk-weighted exposure amounts of the institution calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013;
- (b) the institution-specific countercyclical capital buffer shall be no more than 0,625 % of the total of the risk-weighted exposure amounts of the institution calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013.

3. For the period from 1 January 2017 until 31 December 2017:

- (a) the capital conservation buffer shall consist of Common Equity Tier 1 capital equal to 1,25 % of the total of the risk-weighted exposure amounts of the institution calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013;
- (b) the institution-specific countercyclical capital buffer shall be no more than 1,25 % of the total of the risk-weighted exposure amounts of the institution calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013.

4. For the period from 1 January 2018 until 31 December 2018:

- (a) the capital conservation buffer shall consist of Common Equity Tier 1 capital equal to 1,875 % of the total of the risk-weighted exposure amounts of the institution calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013;
- (b) the institution-specific countercyclical capital buffer shall be no more than 1,875 % of the total of the risk-weighted exposure amounts of the institution calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013.

5. The requirement for a capital conservation plan and the restrictions on distributions referred to in Articles 141 and 142 shall apply during the transitional period between 1 January 2016 and 31 December 2018 where institutions fail to meet the combined buffer requirement taking into account the requirements set out in paragraphs 2 to 4 of this Article.

6. Member States may impose a shorter transitional period than that specified in paragraphs 1 to 4 and thereby implement the capital conservation buffer and the countercyclical capital

buffer from 31 December 2013. Where a Member State imposes such a shorter transitional period, it shall inform the relevant parties, including the Commission, the ESRB, EBA and the relevant supervisory colleges, accordingly. Such a shorter transitional period may be recognised by other Member States. Where another Member State recognises such a shorter transitional period, it shall notify the Commission, the ESRB, EBA and the relevant supervisory college accordingly.

7. Where a Member State imposes a shorter transitional period for the countercyclical capital buffer the shorter period shall apply only for the purposes of the calculation of the institution-specific countercyclical capital buffer by institutions that are authorised in the Member State for which the designated authority is responsible.

### CHAPTER 3

#### **Final provisions**

##### Article 161

#### **Review and report**

1. The Commission shall conduct periodic reviews of the implementation of this Directive in order to ensure that its implementation does not result in manifest discrimination between institutions on the basis of their legal structure or ownership model.

2. By 30 June 2016, the Commission shall, in close cooperation with EBA, submit a report to the European Parliament and to the Council, together with a legislative proposal if appropriate, on the provisions on remuneration in this Directive and in Regulation (EU) No 575/2013, following a review thereof, taking into account international developments and with particular regard to:

- (a) their efficiency, implementation and enforcement, including the identification of any lacunae arising from the application of the principle of proportionality to those provisions;
- (b) the impact of compliance with the principle in Article 94(1)(g) in respect of:
  - (i) competitiveness and financial stability; and
  - (ii) any staff working effectively and physically in subsidiaries established outside the EEA of parent institutions established within the EEA.

That review shall consider, in particular, whether the principle set out in Article 94(1)(g) should continue to apply to any staff covered by point (b)(ii) of the first subparagraph.

3. From 2014, EBA shall, in cooperation with EIOPA and ESMA, publish a biannual report analysing the extent to which Member States' law refers to external credit ratings for regulatory purposes and the steps taken by Member States to reduce such references. Those reports shall outline how the competent authorities meet their obligations under Article 77(1) and (3) and Article 79(b). Those reports shall also outline the degree of supervisory convergence in that regard.

4. By 31 December 2014, the Commission shall review and report on the application of Articles 108 and 109 and shall submit that report to the European Parliament and to the Council together with a legislative proposal if appropriate.

5. By 31 December 2016, the Commission shall review and report on the results achieved under Article 91(11), including the appropriateness of benchmarking diversity practices, taking into account all relevant Union and international developments, and shall submit that report to the European Parliament and to the Council together with a legislative proposal if appropriate.

6. By 31 December 2015, the Commission shall consult the ESRB, EBA, EIOPA, ESMA and other relevant parties on the effectiveness of information-sharing arrangements under this Directive, both in normal times and during times of stress.

7. By 31 December 2015, EBA shall review and submit a report to the Commission on the application of this Directive and of Regulation (EU) No 575/2013 on the cooperation of the Union and Member States with third countries. That report shall identify any areas which require further development as regards cooperation and information sharing. EBA shall publish the report on its website.

8. Upon receiving a mandate from the Commission, EBA shall explore whether financial sector entities which declare that they carry out their activities in accordance with Islamic banking principles are adequately covered by this Directive and by Regulation (EU) No 575/2013. The Commission shall review the report prepared by EBA and shall submit a legislative proposal to the European Parliament and to the Council if appropriate.

9. By 1 July 2014, EBA shall report to the Commission on credit institutions' use of and benefits from ESCB central banks longer-term refinancing operations and similar central bank funding support measures. Based on that report and after consulting the ECB, the Commission shall, by 31 December 2014, submit a report to the European Parliament and to the Council on the use of and benefits from those refinancing operations and funding support measures for credit institutions authorised in the Union, together with a legislative proposal on the use of such refinancing operations and funding support measures if appropriate.

#### Article 162

#### Transposition

1. By 31 December 2013 Member States shall adopt and publish the laws, regulations and administrative provisions necessary to comply with this Directive.

Member States shall apply those provisions from 31 December 2013.

Member States shall communicate to the Commission and to EBA the text of the main provisions of national law which they adopt in the field covered by this Directive. Where the documents accompanying notification of transposition measures provided by Member States are not sufficient to assess fully the compliance of the transposing provisions with certain provisions of this Directive, the Commission may, upon EBA's request with a view to carrying out its tasks under Regulation (EU) No 1093/2010, or on its own initiative, require Member States to provide more detailed information regarding the transposition and implementation of those provisions and this Directive.

2. By way of derogation from paragraph 1, Title VII, Chapter 4 shall apply from 1 January 2016.

3. The laws, regulations and administrative provisions necessary to comply with Article 94(1)(g) shall require institutions to apply the principles laid down therein to remuneration awarded for services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before or after 31 December 2013.

4. When Member States adopt the provisions referred to in paragraphs 1 and 2, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. They shall also include a statement that references in existing laws, regulations and administrative provisions to the Directives repealed by this Directive shall be construed as references to this Directive. Member States shall determine how such reference is to be made and how that statement is to be formulated.

5. By way of derogation from paragraph 1 of this Article, Article 131 shall apply from 1 January 2016. Member States shall implement Article 131(4) from 1 January 2016 in the following manner:

(a) 25 % of the G-SII buffer, set in accordance with Article 131(4), in 2016;

(b) 50 % of the G-SII buffer, set in accordance with Article 131(4), in 2017;

(c) 75 % of the G-SII buffer, set in accordance with Article 131(4), in 2018; and

(d) 100 % of the G-SII buffer, set in accordance with Article 131(4), in 2019.

6. By way of derogation from paragraph 2 of this Article, Article 133 shall apply from 31 December 2013.

*Article 163*

**Repeal**

Directives 2006/48/EC and 2006/49/EC are repealed with effect from 1 January 2014.

References to the repealed Directives shall be construed as references to this Directive and to Regulation (EU) No 575/2013 and shall be read in accordance with the correlation table set out in Annex II to this Directive and in Annex IV to Regulation (EU) No 575/2013.

*Article 164*

**Entry into force**

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

*Article 165*

**Addressees**

This Directive is addressed to the Member States.

Done at Brussels, 26 June 2013.

*For the European Parliament*

*The President*

M. SCHULZ

*For the Council*

*The President*

A. SHATTER

## ANNEX I

**LIST OF ACTIVITIES SUBJECT TO MUTUAL RECOGNITION**

1. Taking deposits and other repayable funds.
2. Lending including, inter alia: consumer credit, credit agreements relating to immovable property, factoring, with or without recourse, financing of commercial transactions (including forfeiting).
3. Financial leasing.
4. Payment services as defined in Article 4(3) of Directive 2007/64/EC.
5. Issuing and administering other means of payment (e.g. travellers' cheques and bankers' drafts) insofar as such activity is not covered by point 4.
6. Guarantees and commitments.
7. Trading for own account or for account of customers in any of the following:
  - (a) money market instruments (cheques, bills, certificates of deposit, etc.);
  - (b) foreign exchange;
  - (c) financial futures and options;
  - (d) exchange and interest-rate instruments;
  - (e) transferable securities.
8. Participation in securities issues and the provision of services relating to such issues.
9. Advice to undertakings on capital structure, industrial strategy and related questions and advice as well as services relating to mergers and the purchase of undertakings.
10. Money broking.
11. Portfolio management and advice.
12. Safekeeping and administration of securities.
13. Credit reference services.
14. Safe custody services.
15. Issuing electronic money.

The services and activities provided for in Sections A and B of Annex I to Directive 2004/39/EC, when referring to the financial instruments provided for in Section C of Annex I of that Directive, are subject to mutual recognition in accordance with this Directive.

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## ANNEX II

## CORRELATION TABLE

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