

EBA/RTS/2021/14

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Final Report

Draft Regulatory Technical Standards

on the calculation of risk-weighted exposure amounts of CIUs
under Article 132a(4) of the CRR

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1. Executive Summary

With regards to approaches for calculating exposure amounts of collective investment undertakings (CIUs), Article 132a (4) of the CRR2 contains a mandate for the EBA to develop draft regulatory technical standards (RTS) to specify how institutions shall ‘... *calculate the risk-weighted exposure amount referred to in paragraph 2 [i.e. the mandate-based approach, MBA] where one or more of the inputs required for that calculation are not available*’.

It is the view of the EBA that this mandate for the RTS in Article 132a(4) of the CRR2 is intended to clarify the way forward when the information for applying the MBA is considered insufficient due to cases of missing inputs for the calculation of exposure values under the MBA.

Moreover, in the case of funds where the total leverage of the fund is limited through market risk measures, which do not limit the actual exposure amounts by specifying limits for the notional amount of derivatives and for the counterparty credit risk exposure incurred by the CIU, the MBA cannot apply and thus the approach to be used is the fall-back approach (FBA).

Consequently the mandate can only be understood as referring to missing inputs for the exposure value calculation despite having both pieces of information (i.e. i) the maximum extent permitted for investing into exposures attracting the highest RW, and ii) the maximum allowed extent of leverage, if applicable). This is particularly relevant in the case of the underlying risk of a derivative or regarding the CCR associated with the fund’s derivative exposures.

Therefore, the present draft RTS first clarify the steps to be taken for computing the exposure value of CIUs’ derivatives exposures where the underlying is unknown, then provide for cases where the calculation of the exposure amount to counterparty credit risk of a netting set of CIUs’ derivative exposures is needed. The proposed provisions follow closely both the Basel framework for equity exposures into funds as well as the CRR2 framework for counterparty credit risk.

The Final Report explains the policy choices of regulatory requirements for the draft RTS and outlines their legislative basis. The EBA is of the view that the proposed regulatory requirements ensure a proportionate and technically consistent treatment of exposures to funds.

2. Background and rationale

1. In December 2013, the Basel Committee on Banking Supervision (BCBS) published the final version of its policy framework for the prudential treatment of banks' equity investments in funds that are held in the banking book¹, including off-balance sheet exposures, and reflecting both the risk of the funds' underlying investments and its leverage. This revised set of rules applies to investments in all types of funds and is applicable to *all* banks, irrespective of whether they apply the Basel framework's Standardised Approach (SA) or an Internal Ratings-Based (IRB) approach for credit risk.
2. As part of the Risk Reduction Measures (RRM) package adopted by the European legislators in May 2019, Article 132a of the CRR as amended (hereafter CRR2)² transposes in the EU regulatory framework this Basel Committee's standard for the calculation of the minimum capital requirements for institutions' equity investments in "Collective Investment Undertakings" ("CIUs")³. The revised requirements of those exposures, which are more risk sensitive and promote transparency, include three different approaches:
 - the "look-through approach" ("LTA"), where institutions shall look through to the individual underlying exposures of a CIU to calculate the risk-weighted exposure amount of the CIU, risk-weighting all underlying exposures of the CIU as if they were directly held by those institutions,
 - the "mandate-based approach" ("MBA"), where institutions that do not have sufficient information about the individual underlying exposures of a CIU to use the look-through approach may calculate the risk-weighted exposure amount of those exposures in accordance with the limits set in the CIU's mandate and relevant law,
 - the "fall-back approach" ("FBA"), which has to be used by institutions that apply neither the LTA nor the MBA and applies a fixed risk weight of 1250% to all exposures in the form of units or shares in CIUs that are subject to this approach.

2.1 Mechanics of different approaches for calculating risk-weighted exposure amounts of CIUs under the CRR2

3. The use of the LTA requires that the information necessary to carry out the required calculations is available either to the institution itself or a third party that is also allowed to carry out these calculations, which can either be the depository institution or the depository financial institution of the CIU or the CIU management company as specified in Article 132 (4) (a) of the CRR. Where the information is not sufficient to allow the look-through to the individual exposures of the CIU, but

¹ <https://www.bis.org/publ/bcbs266.pdf>

² See Regulation (EU) 2019/876 of 20 May 2019 ("CRR2") (<https://data.consilium.europa.eu/doc/document/ST-6288-2019-INIT/en/pdf>), amending Regulation (EU) No 575/2013

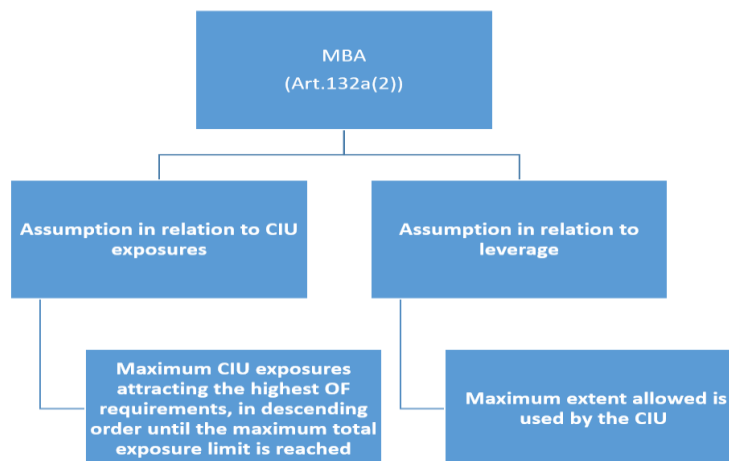
³ According to the CRR2, CIU means (1) a UCITS as defined in Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council or (2) an alternative investment fund (AIF) as defined in point (a) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council

there are limits set in the CIU's mandate and relevant law, the MBA should be used. Where the use of neither the LTA nor the MBA is feasible due to insufficient information regarding the investment structure or the maximum leverage, institutions are required to use the FBA. According to Article 132 (2) of the CRR, institutions may also use a combination of the above approaches, provided that the conditions for using those approaches are met.

4. In order to apply the MBA, Articles 132(2) and 132a(2) of the CRR require that the conditions in Article 132(3) of the CRR are met. More specifically, point (ii) of paragraph (3) (c) requires that the granularity of the financial information be sufficient to allow the calculation of a CIU's risk-weighted exposure amount (RWEA) in accordance with the MBA. The minimum granularity of the financial information for the MBA is determined by Article 132a(2) of the CRR, which requires information to be specified under the CIU's mandate or the relevant law about:
 - a. The maximum extent allowed for investing into exposures which attract the highest RWEAs;
 - b. The maximum extent of leverage allowed, where applicable: a CIU may be permitted to hold more assets, off-balance sheet obligations and contingent obligations (including from derivatives) than the capital provided by equity investors.
5. Article 132a (4) of the CRR2 contains a mandate for the EBA to develop draft regulatory technical standards to specify how institutions shall '*... calculate the risk-weighted exposure amount referred to in paragraph 2 [i.e. the MBA] where one or more of the inputs required for that calculation are not available*'.

2.2 The scope of the EBA mandate

6. The MBA is not completely new and is derived from the "average risk weight approach" (ARWA) referred to in Article 132(5) of the CRR. Compared to the ARWA, the MBA appears to be much more elaborated, since the MBA is not only meant to capture the composition of the CIU's exposures (by type of assets), but also the maximum extent of the CIU's leverage.
7. According to the current treatment of exposures in the form of units or shares in CIUs in Article 132(1) of the CRR, institutions can apply a 100% RW even in cases where they have no information about the underlying exposures (credit risk and counterparty credit risk) and the leverage of the CIU. This will no longer be possible under the CRR2 rules as, in this case, the FBA will apply and the investment in the CIU will receive a 1250% RW. More specifically, under the CRR2, institutions may apply the MBA, provided that sufficient information is available based on the CIU's mandates. In this case, Article 132a(2) CRR2 applies according to the following scheme:



8. There can be situations where the information on the maximum CIU exposures attracting the highest own funds requirements or the maximum leverage allowed is not readily available. As well as this, there are situations where missing inputs do not allow for computing the risk-weighted exposure amount (e.g. in the case of funds where the total leverage of the fund is limited through market risk measures, which do not limit the actual exposure amounts by specifying limits for the notional amount of derivatives and for the counterparty credit risk exposure incurred by the CIU). In both cases, the FBA applies and the institutions shall be required to assume a full investment into exposures attracting a 1250% RW, but for different reasons: in the former, due to the fact that the level 1 text clarifies that the FBA shall apply when insufficient information is available for applying the MBA; in the latter, as inputs are missing and the computation of the RWEA is not feasible.
9. It should be noted that, in the view of the EBA, the mandate for the RTS in Article 132a(4) of the CRR2 is intended to clarify the way forward when the information for applying the MBA is considered insufficient due to cases of missing inputs for the calculation of RWEAs under the MBA. More precisely, this cannot be understood as referring to cases where any of the two pieces of information required for the application of the MBA (i.e. maximum extent of exposures attracting the highest own funds requirement and the maximum extent of leverage as explained above) with regard to a specific CIU is missing. Consequently, the mandate can only be understood as referring to missing inputs for the RWEA calculation despite having both pieces of information (i.e. i) the maximum extent permitted for investing into exposures attracting the highest RWEA, and ii) the maximum allowed extent of leverage, if applicable). This is particularly relevant in the case of the underlying risk of a derivative or regarding the CCR associated with the fund's derivative exposures.
10. The provisions in the CRR provide an incentive for banks to only invest in funds where they have sufficient information regarding all underlying risks, including those stemming from the use of derivatives, or, as an optimum of second best, where there is information available in the funds' mandates or national law. This incentive would be weakened if the mandate in Article 132a (4) of the CRR would be interpreted in a way that the EBA should, for example, provide guidance for identifying the second piece of information about the maximum allowed leverage, where this is not quantified as a multiple of the CIU's equity but, for example, in relation to the loss risk of the portfolio. This could be in particular relevant where the loss risk is not related to invested amounts (such as for loans, bonds or equity investments), but to the leverage effectively provided by the

counterparty of a derivative where the exposure value could increase beyond the nominal amount to be paid or received by the institution. If the mandate was interpreted in such an extensive way, it may also be in contradiction of the rules set out in Articles 132(2) and (3) and 132a(2) of the CRR.

11. Therefore, the present draft RTS first clarify the steps to be taken for determining the exposure value of CIUs' derivatives exposures where the CIUs' mandate does not exclude that the underlying constitutes an on- or off-balance sheet exposure, but where the actual exposure value or, for off-balance sheet exposures, the applicable percentage of this underlying exposure is unknown. The draft RTS then provide for cases where the calculation of the exposure value to counterparty credit risk of a netting set of CIUs' derivative exposures is needed.
12. Following the mechanics of the MBA, the exposure values determined in accordance with the draft RTS will then be multiplied by the relevant risk weights of the underlying of the derivatives or the counterparties of the derivative exposures in the case of counterparty credit risk as given by the mandate and any relevant legal provisions specifying the investment policy of the CIU. Where the provisions specifying the investment policy of the CIU do not include any limitations (e.g. regarding permitted types of exposures, in particular securitisation exposures), these risk weights will be 1250% in the case of the underlying of derivatives or 150% in the case of counterparty credit risk exposures that do not qualify as securitisation exposures. The proposed provisions follow closely both the Basel framework for equity exposures into funds as well as the CRR2 framework for counterparty credit risk.
13. With respect to the calculation of the exposure value for determining the counterparty credit risk of a netting set, which according to Article 272(4) of the CRR may be represented by one or more transactions of derivatives of the same type, provisions are made for substituting, where needed, the replacement cost and potential future exposure.

3. Draft regulatory technical standards

on the calculation of risk-weighted exposure amounts of CIUs under Article 132a(4) of the CRR

COMMISSION DELEGATED REGULATION (EU) No .../..**of XXX****[...]****supplementing 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 with regard to regulatory technical standards on approaches for calculating risk-weighted exposure amounts of CIUs under Article 132a(4) of the CRR**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
Having regard to 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 648/2012⁴, and in particular the third subparagraph of Article 132a(4) thereof,

Whereas:

- (1) According to Article 132a(2) of Regulation (EU) No 575/2013, where the conditions set out in Article 132(3) are met, institutions that do not have sufficient information about the individual underlying exposures of a CIU to use the look-through approach may calculate the risk-weighted exposure amount of those exposures in line with the limits set in the CIU's mandate and the relevant law. The method for calculating the risk weighted exposure amount for a CIU in case one or more inputs required for that calculation are missing should be specified in a regulation.
- (2) Where a CIU enters into derivative transactions and the underlyings of the derivatives or the underlying risk of the derivatives positions are unknown, institutions should base their calculations on the notional amount of a derivative's position.
- (3) Where the CIU's mandate does not exclude entering into derivatives but does not include sufficient information to determine whether an underlying constitutes an on- or off-balance sheet exposure, it cannot be excluded that such an exposure is constituted and therefore needs to be included in the calculation of risk-weighted exposure amounts of CIU's exposures.
- (4) Where the mandate does not provide sufficient information about the exposure value of such an exposure, it cannot be excluded that the exposure values is the full notional amount of the derivative position.

- (5) Where the notional amount of derivative position is not specified by the mandate, this needs to be derived from the maximum notional amount of derivatives allowed under the mandate.
- (6) Where the replacement costs or the potential future exposure for the purposes of calculating the exposure amount associated with Counterparty Credit Risk are unknown, institutions should base their calculations on the sum of notional amounts of the transactions in the netting set.
- (7) Where institutions are not aware of the relevant netting sets for a certain type of derivatives in the CIU, and thus no information on the counterparties or on whether the transactions are subject to a legally enforceable bilateral netting agreement in line with Article 272(4) of Regulation (EU) No 575/2013 is available, institutions should assume that neither netting effects nor counterparty diversification exist for this type of derivative, and should therefore assume that the CIU has entered into a single derivative with the maximum notional amount allowed by the mandate for that type of derivative.
- (8) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (9) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010⁵].

HAS ADOPTED THIS REGULATION:

Article 1

Determination of the exposure value of a CIU's derivatives exposures where the underlying is unknown for the purposes of Article 132a(2) of Regulation (EU) No 575/2013

1. Under the mandate-based approach referred to in Article 132a(2) of Regulation (EU) No 575/2013, where the CIU's mandate does not exclude that the underlying of a CIU's derivative position constitutes an on- or off-balance sheet exposure but the exposure value or, in case of off-balance sheet exposures, the applicable percentage is unknown, institutions shall use the full notional amount of the derivative position as exposure value for the calculation of the risk-weighted exposure amounts.
2. Under the mandate-based approach referred to in Article 132a(2) of Regulation (EU) No 575/2013, where the notional amount of the derivative positions as referred to in paragraph 1 is unknown, institutions shall use a conservative estimation based on the maximum notional amount of the derivatives allowed under a fund's mandate for the determination of the exposure values of an underlying exposure as referred to in paragraph 1.

⁵ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

Article 2

Calculation of the exposure values for counterparty credit risk of a netting set of CIU's derivative exposures

1. Institutions calculating the exposure value for counterparty credit risk in accordance with the method set out in section 3 of Chapter 6 of Regulation (EU) No 575/2013, where replacement costs are unknown, shall use the sum of notional amounts of the derivatives in the netting set. Where the potential future exposure is unknown, institutions shall replace it by 0.15 times the sum of notional amounts of the derivatives in the netting set, setting to 1 the multiplier of Article 278(3) of Regulation (EU) No 575/2013. If both replacement cost and potential future exposure are unknown, both shall be replaced as provided for in this subparagraph.
2. Institutions calculating the exposure value for counterparty credit risk in accordance with the method set out in section 4 or section 5 of Chapter 6 of Regulation (EU) No 575/2013, where replacement costs are unknown, shall use the sum of notional amounts of the transactions in the netting set. Where the potential future exposure is unknown, institutions shall replace it by 0.15 times the sum of notional amounts of the transactions in the netting set. If both replacement cost and potential future exposure are unknown, both shall be replaced as provided for in this subparagraph.
3. Institutions calculating the exposure value for counterparty credit risk in accordance with paragraphs 1 and 2 in the present Article, where the notional amount of the derivatives in the netting set is unknown, shall use a conservative estimation based on the maximum notional amount of the derivatives allowed under a fund's mandate for the determination of the exposure value of that netting set.
4. For the purposes of paragraphs 1, 2 and 3 of the present Article, when institutions are not aware of the relevant netting sets for a certain type of derivatives in the CIU, they shall assume that the CIU has entered into a single derivative with the maximum notional amount permitted by the mandate for that type of derivative.

Article 3

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

[Position]

4. Accompanying documents

4.1 Draft cost-benefit analysis / impact assessment

14. Article 132a (4) of the Regulation (EU) 2019/876 of the European Parliament and the Council of 20 May 2019 (from now on CRR2) amending Regulation (EU) No 575/2013 (as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012), mandated the EBA to develop regulatory technical standards to specify how institutions shall calculate the risk-weighted exposure amount referred to in paragraph 2 where one or more of the inputs required for that calculation are not available. Paragraph 2 of the aforementioned article refers to the calculation using the mandate-based approach.

15. The current draft RTS aim to answer the mandate in Article 132a (4).

16. As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any RTS developed by the EBA shall be accompanied by an Impact Assessment (IA) annex which analyses 'the potential related costs and benefits' before submitting to the European Commission. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

17. For the purposes of the IA section of the Final report, the EBA prepared the IA with cost-benefit analysis of the policy options included in the regulatory technical standards described in this Final report. Given the nature of the study, the IA is high-level and qualitative in nature.

A. Problem identification

18. The primary problem that this RTS aims to address is to answer the aforementioned mandate. The CRR2 transposes the Basel Committee's recommendations for the calculation of the minimum capital requirements for banks' equity investments in funds into European law. One of the methods introduced by the CRR2 is the mandate-based approach (MBA), where institutions that do not have sufficient information about the individual underlying exposures of a CIU to use the look-through approach may calculate the risk-weighted exposure amount of those exposures in accordance with the limits set in the CIU's mandate and relevant law.

19. In order to apply the MBA, it is required that conditions of the CRR are met. Specifically, it is required that i) the maximum extent permitted for investing into exposures attracting the highest RWEA, and ii) the maximum extent of leverage allowed are known. Nevertheless, there



could be cases where there are missing inputs and the granularity of the financial information is not sufficient to allow the calculation of CIU's risk-weighted exposure amount (RWEA) in accordance with the MBA.

20. The existing regulation does not specify how these missing inputs should be measured in those cases where not all the relevant information is available but the institution is still eligible for the application of the MBA.

B. Policy objectives

21. The main objective of the draft RTS is to answer the mandate established in Article 132a (4) of the CRR2. As a result, the general objective of the RTS is to complete the framework specifying the methodology to apply when there are some missing inputs for the complete application of the MBA.

22. The specific objectives of the RTS are:

- a. To define the methodology to determine the exposure amounts for the underlying of derivatives;
- b. To specify the methodology to calculate the counterparty credit risk.

C. Baseline scenario

23. Currently, the CRR2 requires that the following information is available and known to apply the MBA:

- a. the maximum extent permitted for investing into exposures attracting the highest RWEA, and
- b. the maximum extent of leverage allowed.

24. In those cases where any of those two pieces of information are missing, institutions shall apply the most conservative fallback approach. Nevertheless, for cases where those two items are available but some additional inputs are missing, there is currently no methodology applicable to estimate those missing inputs.

D. Options considered

25. When drafting the present draft RTS, the EBA considered several policy options under two main areas:

- a. Regarding the specification of how to determine the exposure values for the underlying of derivatives, the option of using the maximum notional amount of derivatives was considered as opposed to the option of not using this maximum.



- b. **Regarding how to calculate counterparty credit risk**, the option of following the specifications in the CCR regulation was considered, as opposed to defining a completely new framework.

E. Assessment of the options and the preferred option(s)

26. Regarding the specification of how to determine the exposure values for the exposures constituted by an underlying of derivatives, where no or insufficient information about the actual underlying is available, it was considered that the notional amount of the derivative in contrast to market risk-based estimates is a more reliable proxy for capturing the exposure value taking into account that the underlying of a derivative could turn into an actual cash position of the CIU. Where the notional amount of the derivative positions is unknown, the consideration of maximum notional amount of derivatives allowed under a fund's mandate is an appropriate balance between conservative/prudent approaches keeping enough risk sensitivity.
27. Regarding how to calculate counterparty credit risk, chapter 6 of the CRR already foresees a framework to determine the exposure value for CCR. The extension of such framework to the application of the MBA would lead to a consistent framework and would also reduce the burden on institutions as they are already familiar with the existing framework. Therefore, the preferred option is to align the method in this RTS with the CCR framework in the CRR.

4.2 Views of the Banking Stakeholder Group (BSG)

28. The EBA Banking Stakeholder Group provided no comment on these draft RTS.

4.3 Feedback on the public consultation

29. There were no comments provided during the public consultation on these draft RTS.