



EBA Consultation Paper

on

Draft Regulatory Technical Standards

on

**the specification of the calculation of specific
and general credit risk adjustments according
to Article 105(4) of the draft Capital
Requirements Regulation (CRR)**

(EBA/CP/2012/10)

London, 17.07.2012

Contents

I. Responding to this Consultation	3
II. Executive Summary	4
III. Background and rationale	5
IV. Draft Regulatory Technical Standards on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) of the draft CRR.....	8
V. Accompanying documents	18
<i>a. Draft Cost-Benefit Analysis</i>	18
<i>b. Overview of questions for Consultation</i>	23

I. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in Section V.b.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question/Article to which the comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices EBA should consider.

Please send your comments to the EBA by email to EBA-CP-2012-10@eba.europa.eu by 30.09.2012, indicating the reference 'EBA/CP/2012/10' in the subject field. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the EBA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eba.europa.eu under the heading 'Legal Notice'.

II. Executive Summary

The CRR/CRD IV proposals¹ (the so-called Capital Requirements Regulation - henceforth 'CRR'- and the so-called Capital Requirements Directive - henceforth 'CRD') set out prudential requirements for banks and other financial institutions which are expected to apply from 1 January 2013.

The CRR contains specific mandates for the EBA to develop draft Regulatory Technical Standards (henceforth 'RTS') to specify, among others, the calculation of general and specific credit risk adjustments.

These standards will be part of the single rulebook enhancing regulatory harmonisation in Europe.

Please note that the EBA has developed the present draft RTS based on the European Commission's legislative proposals for the CRR/CRD IV. It has also taken into account major changes subsequently proposed by the revised texts produced by the Council of the EU and the European Parliament, during the ordinary legislative procedure (co-decision process).

Following the end of the consultation period, and to the extent that the final text of the CRR changes before the adoption of the RTS, the EBA will adapt the draft RTS accordingly to reflect any developments.

Main features of the RTS

This consultation paper puts forward draft RTS related to Article 105(4) of the CRR to specify the calculation of specific credit risk adjustments (SCRAs) and general credit risk adjustments (GCRAs) under the applicable accounting framework for:

- (i) the determination of exposure values according to Articles 106, 162 to 164, 241 and 261 CRR;
- (ii) the treatment of expected loss amounts according to Article 155 CRR; and
- (iii) the determination of default under Article 174 CRR.

The EBA must submit the draft RTS to the Commission by 1 January 2013.

¹ Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, published on 20th July 2011.

III. Background and rationale

Draft RTS on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) of the draft CRR

The so-called Omnibus Directive² amended the Directives that are collectively known as the Capital Requirements Directive (CRD)³ in a number of ways, one of which was by establishing areas where the EBA is mandated to develop draft technical standards.

On July 20th 2011, the European Commission (EC) issued its legislative proposals on a revision of the CRD which seeks primarily to apply the Basel III framework in the EU. These proposals have recast the contents of the CRD into a revised CRD and a new CRR – which are commonly referred to as the CRR/CRD IV proposals. These are currently being debated by the EU legislators (Council of the EU and European Parliament) in the framework of the ordinary legislative process (co-decision process).

Please note that the EBA has developed the present draft RTS based on the European Commission's legislative proposals for the CRR/CRD IV. It has also taken into account major changes subsequently proposed by the revised texts produced by the Council of the EU and the European Parliament, during the ordinary legislative procedure (co-decision process).

Following the end of the consultation period, and to the extent that the final text of the CRR changes before the adoption of the RTS, the EBA will adapt the draft RTS accordingly to reflect any developments.

The nature of RTS under EU law

Draft RTS are produced in accordance with Article 10 of the EBA Regulation⁴. According to Article 10(4) thereof, they shall be adopted by means of Regulations or Decisions.

² Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directive 98/26/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authorities: the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

³ Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive 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.

⁴ 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.

According to EU law, EU Regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except insofar as this is expressly required by them.

Shaping these rules in the form of a Regulation would ensure a level-playing field and would facilitate the cross-border provision of services.

Background on this draft RTS

Article 105(4) of the CRR requires the EBA to develop (and submit to the Commission by 1 January 2013) a draft RTS aimed at specifying the calculation of specific credit risk adjustments (SCRA) and general credit risk adjustments (GCRA) under the applicable accounting framework for the purposes of determining: (a) the exposure value under the Standardised Approach referred to in Article 106 of the CRR; (b) the exposure value under the IRB Approach referred to in Articles 162 to 164 of the CRR; (c) the treatment of expected loss amounts referred to in Article 155 of the CRR; (d) the exposure value for the calculation of the risk-weighted exposure amounts for securitisation position referred to in Articles 241 and 261 of the CRR; and (e) an indication of unlikelihood to pay when determining whether an obligor has defaulted under Article 174 of the CRR⁵.

Since all the provisions in the scope of this RTS pertain to the determination of own funds requirements for credit risk, the required calculation is necessarily limited to the amounts of such adjustments that reflect losses exclusively related to credit risk that reduce the institution's Core Equity Tier 1 capital (CET1).

Further, while some of the provisions within the scope of Article 105(4) of the CRR refer explicitly to off-balance sheet exposures, others do not distinguish between on- and off-balance sheet exposures. Therefore the required calculation shall not be limited to credit risk adjustments for on-balance sheet items. This RTS has been drafted in a way that can be applied irrespective of the accounting framework.

Additionally, some of the provisions in the scope of this RTS refer exclusively to SCRA, and it is therefore necessary to identify which amounts can be included in their calculation. The sole identification criterion derivable from the provisions of the CRR is that SCRA are not eligible for inclusion into Tier 2 capital under the Standardised Approach for credit risk. Therefore, distinguishing whether

⁵ These RTS have also taken into account major changes subsequently proposed by the revised texts produced by the Council of the EU and the European Parliament, during the ordinary legislative procedure (co-decision process). Therefore, no reference is made to Article 122 of the CRR under letter (a), neither to former letter (f) of Article 105(4) of the CRR which referred to the information on specific and general credit risk adjustments required in Article 428 of the CRR. It is however expected that inclusion of this two letters in the scope will not change significantly the content of these RTS.

amounts are to be included into the calculation of SCRA instead of that of GCRA requires identifying those amounts of credit risk adjustments that should be included in the calculation of GCRA consistently with the criteria generally used for identifying which qualify for inclusion within Tier 2 capital.

According to this approach, credit risk adjustments that reflect losses that cannot be ascribed to any particular exposure or group of exposures would still be fully available to meet losses that subsequently materialize and should be added back to capital. In this respect, paragraph 60 of Basel III states that *"provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within Tier 2"*. Additionally, according to paragraph 58 of Basel III the objective of Tier 2 is *"to provide loss absorption on a gone-concern basis"*.

Further, some of the provisions in the scope of this RTS according to Article 105(4) CRR require identifying the SCRA for a single exposure, thus it is necessary to decide how to treat CRAs that meet the criteria for being included in the calculation of SCRA but reflect losses related to credit risk of a whole group of exposures. The assignment of the amount resulting from such SCRA in portions to the exposures in the group shall be done proportionally to the risk-weighted exposures amounts. For this purpose, the exposure values should be determined without taking into account any SCRA.

Finally, for the purpose of identifying, according to Article 174(2) point b of the CRR, whether a SCRA resulting from a significant decline in credit quality has been recognised for a certain exposure, it is necessary to restrict SCRA to those which are ascribed individually to a single exposure. This is necessary because SCRA made for whole groups of exposures do not identify for which of the obligors of the exposures belonging to this group a default event is considered to have occurred. In particular, the existence of a SCRA for a group of exposures is not sufficient reason to conclude that, for each of these obligors, default events have occurred.

IV. Draft Regulatory Technical Standards on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) of the draft Capital Requirements Regulation (CRR)

Structure of the draft RTS

IV. Draft Regulatory Technical Standards on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) of the draft Capital Requirements Regulation (CRR)	8
TITLE I - Subject matter and scope.....	12
TITLE II - Identification of GCRA and SCRA.....	12
TITLE III - Calculation of GCRA and SCRA for own funds requirements	14
TITLE IV - Final provisions	17



EUROPEAN COMMISSION

Brussels, 29.6.2011
C(20..) yyy final

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

of 29.6.2011

THE EUROPEAN COMMISSION,

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

Commission Delegated Regulation (EU) No XX/2012

supplementing [proposal for a] Regulation xx/XX/EU [CRR] of the European Parliament and of the Council of [date] on prudential requirements for credit institutions and investment firms, with regard to regulatory technical standards for specifying the calculation of specific credit risk adjustments and general credit risk adjustments of XX Month 2012

THE EUROPEAN COMMISSION,

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

Having regard to the [proposal for a] Regulation (...) No xx/xxxx of the European Parliament and of the Council of dd mmmm yyyy on prudential requirements for credit institutions and investment firms Regulation xx/xxxx [CRR] and in particular Article 105(4) thereof,

Whereas:

- (1) This Regulation relates to the specification of the amounts that need to be included in the calculation of credit risk adjustments (CRAs) which reflect losses exclusively related to credit risk. Further, the calculation of CRAs for determining the own funds requirements is limited to amounts that have reduced the Common Equity Tier 1 (CET1) of the institution.
- (2) The calculation of CRAs covers both on-balance and off-balance sheet items, in accordance with the provisions of Regulation xx/xxxx [CRR] which refer explicitly to CRAs for off-balance sheet exposures, whereas other provisions do not distinguish between on- and off-balance sheet exposures.
- (3) In order to ensure full coverage of the calculation it is necessary that any amount that is relevant for the purposes listed in Article 105 (4) Regulation xx/xxxx [CRR] is assigned either to the calculation of general credit risk adjustments (GCRAs) or that of specific credit risk adjustments (SCRAs).
- (4) In relation to the identification of the amounts that can be included in the calculation of SCRAs, the only criterion provided by Regulation xx/xxxx [CRR] is that SCRAs are not eligible for inclusion into Tier 2 capital under the Standardised Approach for credit risk. This criterion can be derived from Article 105(1) Regulation xx/xxxx [CRR] which limits the application of the Article 59(c) treatment to GCRAs. Therefore, the distinction of amounts to be included in the calculation of SCRAs or GCRAs needs to be done consistently with the criteria for identifying what can be included in Tier 2 capital.
- (5) Further, paragraphs 58 and 60 of Basel III provide that one of the criteria for this distinction has to be that general provisions or general loan-loss reserves are ‘freely available to meet losses which subsequently materialise’ because paragraph 60 of Basel III states: *‘Provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within Tier 2’*. In addition, amounts included in the calculation of GCRAs should

be fully available, as regards to timing and amount, to meet such losses, at least on a gone-concern basis, as stated under paragraph 58 of Basel III: *'The objective of Tier 2 is to provide loss absorption on a gone-concern basis'*.

- (6) This Regulation has been drafted in such a way so that it can be applied irrespective of the applicable accounting framework.
- (7) Since some of the provisions under the scope of this Regulation require identifying the SCRAs for a single exposure, it is necessary to decide how to treat SCRAs that reflect losses related to credit risk of a whole group of exposures. Further, it is necessary to decide for which exposure(s) in the group and to what extent the SCRAs should be recognised. The assignment of portions of this amount resulting from such SCRAs to the exposures in the group has to be done proportionally to the risk-weighted exposures amounts. For this purpose, the exposure values should be determined without taking into account any SCRAs.
- (8) For the purpose of determination of default under Article 174(2) point b Regulation xx/xxxx [CRR], it is necessary to include only SCRAs which are made individually for a single exposure or a single obligor, and not to include SCRAs made for whole groups of exposures. SCRAs made for whole groups of exposures do not identify for which of the obligors of the exposures belonging to this group a default event is considered to have occurred. In particular, the existence of a SCRA for a group of exposures is not sufficient reason to conclude that for each of these obligors default events have occurred.
- (9) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) to the Commission.
- (10) The European Supervisory Authority (European Banking Authority) has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, in accordance with article 15 of Regulation (EU) No 1093/2010, and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

TITLE I

Subject matter and scope

Article 1

Subject matter and scope

1. This Regulation lays down uniform requirements for the calculation of specific credit risk adjustments and general credit risk adjustments under the applicable accounting framework in accordance with article 105(4) of Regulation (EC) No xxxx/2012 [CRR].

Text for consultation purposes

The scope of this Regulation is determined by Article 105(4) of the Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms (hereinafter 'CRR'). The text of this Article is replicated below in the version that it was agreed by the Council of the EU on May 14th 2012; references to other Articles in it are references to Articles of the CRR.

'EBA shall develop draft regulatory technical standards to specify the calculation of specific credit risk adjustments and general credit risk adjustments under the applicable accounting framework for the following:

- (a) exposure value under the Standardised Approach referred to in Article 106;
- (b) exposure value under the IRB Approach referred to in Articles 162 to 164;
- (c) treatment of expected loss amounts referred to in Article 155;
- (d) exposure value for the calculation of the risk-weighted exposure amounts for securitisation position referred to in Article 241 and 261;
- (e) the determination of default under Article 174.

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

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

TITLE II

Identification of GCRA and SCRA

Article 2

Identification of GCRA and SCRA to be included in the calculation

1. For the purposes of this Regulation, the amounts required to be included in the calculation of general and specific credit risk adjustments shall be equal to all amounts by which an institution's Common Equity Tier 1 capital has been reduced in order to reflect losses

exclusively related to credit risk according to the applicable accounting framework, irrespective of whether they result from provisions, value adjustments or impairments.

2. The amounts described in paragraph 1 shall be included in the calculation of general credit risk adjustments (GCRAs) if they fulfil both of the following criteria:
 - (a) are freely and fully available, as regards to timing and amount, to meet losses that are not yet materialised;
 - (b) reflect credit risk losses for a group of exposures for which the institution has currently no evidence that a loss event has occurred.
3. All other amounts described in paragraph 1 shall be included in the calculation of specific credit risk adjustments (SCRAs).
4. Subject to meeting the criteria of paragraph 2, cases reflecting the following shall be included in the calculation of GCRAs:
 - (a) losses recognised to cover higher average portfolio loss experience over the last years although there is currently no evidence of events supporting these loss level observed in the past;
 - (b) losses estimated for which there has been no evidence of a credit deterioration since initial recognition, but for which a loss event is expected to occur in a future period, based on past experience, market and/or statistical data, adjusted to incorporate all reasonable and supportable information;
 - (c) losses for which the institution is not aware of a credit deterioration for a group of exposures but where some degree of non-payment is statistically probable based on past experience.
5. Cases reflecting the following, shall always be included in the calculation of SCRAs under paragraph 3:
 - (a) losses recognised in the profit or loss account as credit risk impairment for instruments measured at fair value;
 - (b) losses as a result of current or past events affecting a significant individual exposure or exposures that are not individually significant which are individually or collectively assessed;
 - (c) losses for which historical experience, adjusted on the basis of current observable data, indicates that the loss has occurred but the institution is not yet aware which individual exposure has suffered these losses;
 - (d) losses estimated as a result of evidence of a deterioration in credit quality of an exposure or a group of exposures since initial recognition which possibly affect the recoverability of cash flows.

Text for consultation purposes

The criteria of paragraph 2 are drafted in a way that they can be applied irrespective of the accounting framework. However, in order to facilitate institutions in mapping the criteria of

paragraph 2 into their applicable accounting framework, paragraphs 4 and 5 elaborate on certain cases. These create a link to the accounting framework and basically establish what institutions shall do under the applicable accounting framework, but without explicit reference to individual accounting standards.

Thus, paragraph 4 includes three cases reflecting the following situations which are understood to fall under national GAAPs:

- (a) value adjustments following the Accounting directives which may reflect some discretion from the institutions;
- (b) expected losses without evidence of credit deterioration;
- (c) statistical provisions where provisions are established based on the historical experience.

Paragraph 5 contains the following cases which reflect the following situations:

- (a) credit risk losses for instruments measured at fair value (for instance, the Available for Sale category in IFRS);
- (b) "incurred loss" model under IAS 39 and, in particular, includes individually and collectively assessed losses;
- (c) "incurred but not reported losses" recognised under IAS 39;
- (d) losses where there is evidence of deterioration of the credit quality.

Q1: Are the provisions included in this draft RTS on criteria that specify which amounts shall be included in the calculation of GCRA or SCRA respectively, sufficiently clear? Are there aspects which need to be elaborated further?

Q2: Are there any issues regarding the timing of recognition of provisions, value adjustments or impairments in profit or loss and in Common Equity Tier 1 capital?

TITLE III

Calculation of GCRA and SCRA for own funds requirements

Article 3

Assigning SCRA for a group of exposures to the exposures of this group

1. In the case of a SCRA that reflects losses related to the credit risk of a group of exposures, institutions shall assign this SCRA to single exposures of this group proportionally to the risk-weighted exposure amounts. For this purpose, the exposure values shall be determined without taking into account any SCRA.
2. For the treatment of expected loss amounts referred to in Article 155 Regulation xx/xxxx [CRR] for a group of non-defaulted exposures, institutions do not need to assign this SCRA to a single exposure.
3. Where a SCRA relates to a group of exposures the credit risk own funds requirements of which are calculated partially under the Standardised Approach and partially under the Internal Ratings Based Approach, before applying the actions described in paragraphs 1 and 2, the institution shall assign this SCRA to the group of exposures covered by each of

the Approaches proportionally to the exposure amounts of the group. For this purpose, the exposure values shall be determined without taking into account any SCRAs.

4. When assigning the SCRAs to exposures, institutions shall ensure that the same portion is not assigned twice to different exposures.

Text for consultation purposes

This Article clarifies how to assign SCRAs for a group of exposures to the exposures of this group. Some of the provisions of Article 105(4) Regulation xx/xxxx [CRR] require assignation of SCRAs to single exposures, for instance, under the Standardised Approach the exposure value of an asset shall be its accounting value remaining after specific credit adjustments, for this purpose the exposure values should be determined without taking into account any SCRAs. Therefore, it is necessary to assign SCRAs for a group of exposures to each specific exposure. The assignation shall be done proportionally to the risk-weighted exposures amounts. The above proposal is a risk-sensitive approach, because it comprises information on risk weights and gross exposure amounts. When the IRB Approach is used, in most of the cases there is no need to assign the SCRAs to a single exposure as the exposure value shall be the accounting value without taking into account any credit risk adjustment. Finally, paragraph 3 has been included because when the institutions use the IRB Approach and Standardised Approach (stemming roll-out plan or permanent partial use) for a group of exposures, the institution needs to assign portions of the SCRA to the IRB Approach exposures and to the Standardised Approach exposures. The assignation shall be done proportionally to the exposures of the group.

Q3: Are the provisions included in this draft RTS on the criteria to assign SCRAs for a group of exposures sufficiently clear? Are there aspects which need to be elaborated further?

Article 4

Calculation in the context of points (a), (b) and (d) of Article 105(4) Regulation xx/xxxx [CRR]

For the purposes of determining the exposure value under points (a), (b) and (d) of Article 105(4) Regulation xx/xxxx [CRR], SCRAs of an institution shall be calculated as the amounts of SCRAs for a single exposure, or as the amounts of SCRAs that the institution has assigned to an exposure according to Article 3.

Article 5

Calculation in the context of point (c) of Article 105(4) Regulation xx/xxxx [CRR]

1. For the purposes of the treatment of expected loss amounts according to point (c) of Article 105(4) Regulation xx/xxxx [CRR], total GCRAs shall be calculated as the sum of all amounts of GCRAs.
2. For the purpose of the treatment of expected loss amounts according to point (c) of Article 105(4) Regulation xx/xxxx [CRR], total SCRAs shall be calculated as the sum of (a) and (b) below, excluding exposures in default:
 - (a) amounts of SCRAs related to the credit risk of a single exposure; and
 - (b) amounts of SCRAs related to the credit risk of a group of exposures assigned according to Article 3.

3. The total SCRAs for exposures in default shall be calculated as the sum of all amounts of SCRAs that specifically reflect losses related to the credit risk of a single exposure and of a group of exposures assigned according to Article 3.

Text for consultation purposes

Paragraphs 1 and 2 provide the calculation of GCRAs and SCRAs in order to compare expected loss amounts with the SCRAs and GCRAs under Article 155 Regulation xx/xxxx [CRR]. Therefore all SCRAs and GCRAs for institutions applying the IRB approach need to be sum up to make the comparison.

Further, Article 155 CRR clarifies that "specific credit risk adjustments on exposures in default shall not be used to cover expected loss amounts on other exposures". For this reason this article excludes single exposures in default from the calculation and they should be considered in isolation under paragraph 3.

Article 6

Calculation in the context of point (e) of Article 105(4) Regulation xx/xxxx [CRR]

For the purpose of determination of default according to point (e) of Article 105(4) Regulation xx/xxxx [CRR], SCRAs shall be calculated as the amounts of SCRAs related to the credit risk of a single exposure or single obligor.

Text for consultation purposes

For the purpose of identifying, according to Article 174(2) point b Regulation xx/xxxx [CRR], whether a SCRA resulting from a significant decline in credit quality has been recognised for a certain exposure, it is necessary to restrict SCRAs to those which are ascribed individually to a single exposure. This is necessary because SCRAs made for whole groups of exposures do not identify for which of the obligors of the exposures belonging to this group a default event is considered to have occurred. In particular, the existence of a SCRA for a group of exposures is not sufficient reason to conclude that for each of these obligors default events have occurred.

Q4: Are the provisions included in this draft RTS sufficiently clear? Are there aspects which need to be elaborated further?

Article 7

Documentation

The institution shall document its decisions regarding the identification and calculation of GCRAs and SCRAs.

TITLE IV

Final provisions

Article 8

This Regulation shall enter into force twenty days 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*]

V. Accompanying documents

a. Draft Cost-Benefit Analysis

Introduction

According to Article 105(4) of the Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms (CRR), the EBA shall develop draft regulatory technical standards to specify the calculation of specific credit risk adjustments (SCRAs) and general credit risk adjustments (GCRAs) under the applicable accounting framework for the following purposes: (i) exposure values of credit risk exposures under the Standardised Approach for credit risk and under the IRB Approach and treatment of expected loss amounts under the IRB Approach; and (ii) the determination of default; and shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Problem definition

All the Articles in the scope of this Regulatory Technical Standard (RTS) according to Article 105(4) CRR belong to the determination of own funds requirements for credit risk. Specifying the calculation of specific credit risk adjustments (SCRAs) and general credit risk adjustments (GCRAs) for the purposes of Article 105(4) CRR therefore requires identifying which amounts of credit risk adjustments can be included in the calculation with due regard to the prudential nature of these Articles. The role of CRA in these Articles is twofold:

- (i) for the determination of exposure values according to Articles 106, 162 to 164, 241 and 261 CRR and for the treatment of expected loss amounts according to Article 155 CRR: identifying the portion of credit risk exposures that is already covered by own funds according to the applicable accounting framework,
- (ii) for the determination of default under Article 174 CRR: identifying whether a SCRA resulting from significant decline in the credit quality has been recognised for certain exposures.

These specific roles make it necessary to limit the amounts of credit risk adjustments to those reflecting losses exclusively related to credit risk. In addition, the first role, identified under (i) above, requires not only ensuring that own funds in general have been reduced, but that in particular Common Equity Tier 1 (CET1) capital has been reduced.

Furthermore, the calculation of SCRAs and GCRAs needs to be specified in a way that is broad enough to be applied to all of the Articles in the scope of the RTS. For this reason, the calculation of CRAs cannot be limited to those CRAs for on-balance sheet items only because some of the Articles in the scope of the RTS refer to CRAs for determining the exposure value of off-balance sheet exposures

or, like the treatment of expected loss amounts referred to in Article 155 CRR, do not at all distinguish between on- and off-balance sheet exposures.

Moreover, it is necessary to specify the calculation of SCRAs because some of the Articles in the scope of this RTS according to Article 105(4) CRR solely refer to SCRAs. However, the identification criterion derivable from the provisions of the CRR is that SCRAs are not eligible for inclusion into Tier 2 capital under the Standardised Approach for credit risk. Therefore, distinguishing whether amounts are to be included into the calculation of SCRAs instead of that of GCRAs rather requires identifying those amounts of CRAs that should be included in the calculation of GCRAs. In order to avoid inconsistencies, it is in particular necessary to choose the criteria for identifying amounts that can be included in the calculation of GCRAs for the scope of this RTS in a way that is consistent with the criteria generally used for identifying which CRAs qualify as GCRAs for being included in Tier 2 capital.

Last but not least, the purpose of the RTS is to standardise the calculation of GCRAs and SCRAs across the EU. Therefore, it is necessary to determine inclusion of amounts of CRA into this calculation irrespective of which accounting framework (IFRS or any national GAAP) is applicable to a certain institution.

Objectives of the Regulatory Technical Standard

The objective of this RTS is to provide a standardised calculation of SCRAs and GCRAs under the applicable accounting framework across EU Member States for the scope determined by Article 105(4) CRR, which covers Articles 106, 155, 162 to 164, 174, 241 and 261 of the CRR.

The objective of this RTS is to specify how to calculate GCRAs and SCRAs for the Articles in the scope of this RTS from amounts of CRAs that have been made according to the respective applicable accounting framework. Therefore, EBA aimed on specifying how to identify the amounts of CRAs that can be included in the calculation of GCRAs or SCRAs, respectively, for the different purposes of the Articles in the scope of the RTS. The EBA's focus was on providing criteria for identifying those amounts of CRAs that can be included in the calculation of GCRAs so as to ensure full coverage of all other relevant amounts in the calculation of SCRAs. In order to avoid inconsistencies to the Articles of the CRR which determine eligibility of GCRAs for inclusion into Tier 2 capital, the criteria chosen by EBA for including amounts of CRAs into the calculation of GCRAs have been designed for being consistent with the common criteria for identifying which CRAs qualify as GCRAs for being included in Tier 2 capital.

For ensuring that the standardised calculation of GCRAs and SCRAs provided by the RTS is applicable to CRAs by all institutions across the EU, whatever accounting framework is applicable for a certain institution, EBA has strived to design the formula and the criteria for inclusion in the respective calculation in a

manner that is independent of the particular way how the institution's applicable accounting framework achieves that these criteria are met.

Policy options

The need for standardising the calculation of GCRA and SCRA in a manner that is suited for the prudential purposes of the Articles of the CRR in the scope of this RTS (which all relate to own funds requirements for credit risk) as well as the need for consistency with the prudential purposes of other Articles of the CRR outside the scope of this RTS (in particular those which determine the inclusion of GCRA into Tier 2 capital) left limited scope for different policy options. In order to be consistent with paragraphs 58 and 60 of Basel III, there was no other choice than ensuring that those amounts of CRA are included in the respective calculation for which this is appropriate and necessary on the basis of these prudential purposes.

The only instance where a decision between different policy options can be made concerns the calculation of SCRA that reflect losses for a whole group of exposures instead of for a single exposure.

Accordingly, the EBA has identified the following policy options for CRA that meet the criteria for being included in the calculation of SCRA but reflect losses related to credit risk of a whole group of exposures:

- (1) completely ignore such CRA;
- (2) leave to the institutions the decision of how to assign portions of the amount resulting from SCRA to the exposures in the group;
- (3) assign the SCRA to single exposures of the group proportionally to the risk-weighted exposure amounts. For this purpose, the exposure values should be determined without taking into account any SCRA.

Comparison of the options

Option (1) cannot be justified because these CRA meet all of the criteria required for being included into the calculation of SCRA. As the calculation of SCRA for determining own funds requirements is limited to amounts that have reduced CET1 of the institution; both option (2) and (3) ensure that the respective portion of an exposure is covered by own funds.

Option (2) can be justified because institutions could continue to apply current allocation methods. However, option (3) would be the best choice for convergence amongst institutions.

The EBA's decision to follow option (3) is based on the consideration that, the allocation will be done considering proportionally to the risk-weighted exposure

amounts and therefore it is a risk-sensitive approach. It also ensures a consistent application of this RTS.

The likely economic impacts⁶

The RTS contributes to further convergence of the consistency in the calculation of GCRA and SCRA by institutions and thus enhances the level playing field across institutions.

Already Directive 2006/48/EC requires institutions to identify value adjustments and provisions for which it is appropriate to be taken into account when determining exposure values or assessing coverage of expected loss amounts, or for assessing whether a default event has been assumed under the applicable accounting framework. Assuming that institutions have already made the assessment which 'value adjustments' and 'provisions' can be recognised for these purposes in a prudentially sound manner, it can reasonably be assumed that this already matches with the general criteria for including amounts of CRA in the calculation of SCRA and GCRA provided by this RTS, in particular since the particular way of achieving the required features according to the applicable accounting regime is deliberately left open. Similarly, the criteria for identifying amounts of CRA that can be included in the calculation of GCRA are designed to be generally consistent with those which institutions need to apply for identifying GCRA eligible for inclusion into Tier 2 according to Article 59(c) CRR.

The decision on allocation of SCRA proportionally to the risk-weighted exposures amounts may require changes in the current practices of institutions (depending on currently used methods by institutions), however contributes to a consistent application of this RTS and it does not introduce complexity.

Summarised, EBA assumes that the implementation costs of this proposal are negligible, bar the compliance costs for implementing and monitoring this proposal.

For these reasons the impact and costs and benefits related to this draft RTS are unlikely to be of high significance.

The EBA has also included in this consultation a number of questions whose answers will complement the above cost-benefit analyses and will allow for the finalisation of the RTS for submission to the European Commission.

⁶ The EC IA guidelines refer to social and environmental impacts as well. However considerations of these impacts are unlikely to be relevant for EBA technical standards. The potential exceptions being social impacts on employment, standards and rights related to job quality and impacts on (financial) crime.

Q5: Do you support the policy proposal, in particular to the preferred policy option (3), and the EBA's assessment that its impact is relatively immaterial to the CRR text? If not please explain why and provide estimates of such impacts whenever possible.

Q6: What is the incremental cost to your institution for the implementation of this proposal?

Q7: What is the incremental cost for the ongoing compliance with this proposal?

Q8: What is the incremental benefit to your institution for the implementation of this proposal?

Q9: What is the incremental benefit for the ongoing compliance of this proposal?

b. Overview of questions for Consultation

Q1: Are the provisions included in this draft RTS on criteria that specify which amounts shall be included in the calculation of GCRA's or SCRA's respectively, sufficiently clear? Are there aspects which need to be elaborated further?

Q2: Are there any issues regarding the timing of recognition of provisions, value adjustments or impairments in profit or loss and in Common Equity Tier 1 capital?

Q3: Are the provisions included in this draft RTS on criteria to assign SCRA's for a group of exposures sufficiently clear? Are there aspects which need to be elaborated further?

Q4: Are the provisions included in this draft RTS sufficiently clear? Are there aspects which need to be elaborated further?

Q5: Do you support the policy proposal, in particular to the preferred policy option (3), and the EBA's assessment that its impact is relatively immaterial to the CRR text? If not please explain why and provide estimates of such impacts whenever possible.

Q6: What is the incremental cost to your institution for the implementation of this proposal?

Q7: What is the incremental cost for the ongoing compliance with this proposal?

Q8: What is the incremental benefit to your institution for the implementation of this proposal?

Q9: What is the incremental benefit for the ongoing compliance of this proposal?