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Finance for Europe

Association for Financial Markets in Europe

AFME response to EBA consultation on Draft Regulatory Technical Standards on the allocation of off-balance sheet items and UCC considerations under article 111(8) of Regulation (EU) No 575/2013

4 June 2024

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA consultation on Draft Guidelines on the management of ESG risks. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

We welcome the opportunity to provide comments in response to the EBA consultation: *"Draft Regulatory Technical Standards on the allocation of off-balance sheet items and UCC considerations under article 111(8) of Regulation (EU) No 575/2013".*

There are however several key areas where we are concerned by the approach that the EBA has taken in the draft RTS. First, it appears that the EBA has created some confusion over the draft RTS with the result that some CCFs have become harsher than intended by the Basel standard.

Therefore, we would refer the EBA to the changes introduced in the 2017 Basel standards (see summary in Appendix 1), through which the 40% CCF bucket was only applied for CCF relevant to commitments subject to the former 20%/ 50% CCF. Based on the EBA's draft RTS proposal, we have a material concern that some elements intended to be in the 40% CCF bucket will instead be allocated to the 100% bucket. Such a result would undermine the EU's objectives towards the implementation of the Basel 3.1 package. We particularly recommend that RTS Article 1(1) and (2) are more precisely targeted towards those off-balance sheet items that are contingent commitments (i.e. guarantees), thus excluding loan/financing commitments.

The legal mandate indicated in CRR3 states that the EBA should draft the RTS to specify criteria to assign off-balance (OB) items, with "the exception of items already included in Annex I". We underline that there are a number of changes considered by the EBA which are related to items already included in Annex I, and thus out of its mandate, such as loan/ financing commitments, (already specified in bucket 3) or trade finance off balance sheet items (bucket 4, which includes documentary credit) or performance bonds (bucket 2, or, if trade finance, bucket 4).

In relation to the factors specified under Article 2, that institutions are required to consider in relation to their ability to cancel unconditionally cancellable commitments (UCCs), we believe that they do not achieve

the outcome desired by the EBA. In practice as drafted by the EBA none of these conditions could be disproven, therefore creating material uncertainty for banks. We have therefore suggested drafting changes to Article 2 and recommend that the EBA reviews these factors, with a view to achieving a more appropriate specification of factors a) and b), while removing factors c) and d) (given that these refer to ever-present risks and are therefore unachievable). That is why the Basel Committee chose a 10% CCF instead of 0% to cover these risks.

We also note that the EBA has not provided an explanation of how the category '*Other off-balance sheet items carrying similar risk, as communicated to EBA'* could work in practice. As a result, and given the wording of the RTS, these categories are effectively no longer available, despite the Level 1 legislative intent. We acknowledge that Article 3 refers to this issue, but the current wording is insufficient to put the proposed category into practice. Further, the EBA does not explain how the communication process referred to under Q9 would work from the perspective of banks, particularly in relation to the role of national competent authorities.

We want to notify the EBA that so far, the different impact studies required from the industry on Basel III finalisation, have never anticipated any of the effects of the EBA draft RTS:

- UCC were assigned a CCF of 10% without consideration of any disqualifying factors or statement of mandatory CCF application in this situation.
- similarly, any financing commitments, including any term loans or revolvers, or mortgage loans or forward start facilities for instance, were assigned to bucket 3 as per the Basel requirement, without further potential requalification under bucket 1.

We have provided more detailed feedback on the specific questions set by the EBA in the following sections.

Question 1. Do you have any comment on the non-exhaustive list of examples provided?

We welcome the EBA's approach to clarify the type of underlying obligation and the contingency to a non-financial event to determine the CCF to be applied to these products. We note that some of the wording creates uncertainties, as they seem to require a different CCF than was the case under the current CRR and is also not the regulatory intention under Basel 3. We do not view the legal mandate authorising the drafting of the RTS as supporting an intention to change the treatment of products that are already clearly listed within Annex 1.

Forward starting loans – We would like to highlight that most forward starting loans are in practice loan commitments and therefore should be assigned to bucket 3. Otherwise the EBA would be overriding CRR Annex I.. . In the description given by EBA of this kind of facility, the EBA seems to consider that the drawing of a forward starting loan is certain and constitutes an obligation to draw from the borrower for a predetermined amount which is not necessary and is rarely the case. A forward starting loan is generally a facility that cannot be drawn before a certain date and there is rarely a contractual obligation to draw on it.

Documentary credits – these are generally short-term items that are self-liquidating. We note that self-liquidating is broader than collateralised. Bucket 4 of Annex I lists "Short-term, self-liquidating trade letters of credit arising from the movement of goods, in particular documentary credits collateralised by the underlying shipment, in case of an issuing institution or a confirming institution;". The wording "in particular" does not restrict the eligibility to the 20% CCF to L/C that are collateralized. Therefore non-

collateralized L/C eligible as Trade Finance items (as a result of being self-liquidating) are already listed as eligible for the 20% CCF treatment and should not be transferred to bucket 2.

Contingent items where all relevant non-credit risk related conditions have been triggered that previously prevented exposing the institution to the risk of credit losses in case of default of the obligor, and the institution's guarantee is only conditional on a default event for the guaranteed credit obligation. In this case, the variation in the assignment from bucket 1 to bucket 2 would imply a close and dynamic monitoring over time of such related conditions, which is neither trivial nor defined in its execution. We therefore request the EBA to provide further rationale for this dynamic bucket assignment, whose allocation - either to bucket 1 or 2 - is not unequivocally defined.

Contingent items where the conditional event that prevents exposing the institution to the risk of credit losses in case of a default has not been triggered yet but it is related to credit risk, and the institution's guarantee is only conditional on a default event for the guaranteed credit obligation – we are concerned that this potentially would bring performance bonds which are already listed in Annex I buckets 2 and 4, into bucket 1: We think that the wording should be changed to make it clearer that this only applies if the sole remaining trigger is a credit risk related trigger, If a credit related trigger is only one of several triggers (including certain non-credit related triggers), this should not be required to be allocated to bucket 1.

We would like to flag certain issues in relation to the examples listed in Figure 2 of the consultation paper with regards to Contingent liability for chargeback positions in credit card acquiring business. We appreciate that EBA considers chargeback risk clearly not as a full risk item but we disagree with classifying it as an example for bucket 2 in Annex 1 of the CRR. As this is a highly disproportionate overestimation of the actual likelihood of such losses, instead we propose the application of a 10% CCF for chargeback risk. The following points provide a rationale for the classification of this item for bucket 5 in Annex 1:

The realization of a loss due to a chargeback event will only occur if:

- a valid chargeback claim against the merchant is initiated, for example due to fraudulent behavior but not due to refunds from general cancellation rights or refunds under a warranty claims etc; and
- the default of the merchant has occurred and the merchant does not pay; and
- there is no or only insufficient cash collateral from the merchant available.

The actual observed chargeback rates in the industry are very low (below 0.6 % overall). Chargeback rates vary per industry and are different for stationary versus online sales and for some industries, chargeback rates are even less than 0.2 %. We note that fraudulent behavior is already covered by the CRR's capital requirements for operational risk. Therefore, an unjustifiably high CCF for chargeback risk would lead to punitive double counting of this risk, even if it is related to fraud occurring in the sphere of the merchant and not directly involving the bank.

We would also highlight the major difference in capital treatment of chargeback risk that banks (i.e. CRR institutions) are facing, compared to non-bank acquirers (i.e. payment institutions and e-money institutions – PI/EMI). Although a certain capital requirement is prescribed for those non-bank acquirers under PSD, the amount of capital is much smaller than what it would be even when only applying a 10% CCF. This creates an unlevel-playing field between banks and non-banks offering acquiring services which, in the long-run, will not only disable banks from offering acquiring services for cards but also will impact their potential role as acquirer for the digital euro, which is also intended to be introduced with a chargeback approach.

Lastly, we would highlight that BaFin in April 2022 has published an explanatory statement relating to chargeback risk for credit card payments and its capital treatment under CRR [BaFin - Erläuternde Aussagen der BaFin zur CRR und zur VVO - CRR – Berücksichtigung des Rückbelastungsrisikos bei ... LINK]. BaFin issued this explanatory statement as the previously published EBA Q&A 2016_2916 left the applicable CCF for chargeback risk mainly open. Out of the four possible risk items under CRR 2 and considering the 'very low chargeback ratios compared to transaction volumes' BaFin decided that treating chargeback risk as "medium/low risk item" with 20 % CCF would be adequate. As CRR 3 now offers five buckets and given that the lowest bucket no longer has a CCF of 0%, we believe that applying bucket 5 of Annex 1 of CRR 3 would not contradict the argumentation of this BaFin explanatory note.

Question 2. Which is the average period of time for a client to accept a mortgage loan offer?

We would like to note that commitments even not yet accepted by the client are already covered by the CRR3 Article 111 (4) and Article 111(2). That means, irrespective of the average period of time provided by institutions when providing a loan mortgage offer, its CCF treatment is already included into Annex I, under bucket 3.

Therefore, this question should not be of relevance for complying with the EBA's mandate where the EBA is required to provide criteria for those off-balance sheet items not yet covered by the current regulation.

Having said that, it should be noted that particularly for retail mortgages:

- the average period of time for a client to accept a mortgage loan offer varies between jurisdictions/markets
- In many jurisdictions there is no obligation on customers to accept a mortgage offer.
- Given the often complex nature of property purchases, it is not uncommon for retail customers to obtain more than one mortgage offer
- There are generally no penalties for retail customers not to take a mortgage offer

Question 3. What is the applicable percentage that institutions currently apply to these commitments?

For institutions using the SA-CR, in relation to mortgage loans offers, the applicable CCF is dependent on the original maturity of the loan offer as per the current CRR Annex I: 20% if the original maturity is below one year and 50% if it is higher than one year. This treatment has been confirmed by EBA Q&A 2022_6602 on "Estimation of a conversion factor for binding mortgage offers under the IRB Approach". This specified that binding mortgage proposals qualify for the creditor as agreements to lend would not be eligible for modelled CCF under IRB approach (thus subject to CRRIII "SA CCF") but to Medium or Medium/low risk bucket depending on the initial maturity of the offer, that has been merged into bucket 3 – 40% CCF in CRR3. It is clarified therein:

For institutions using internal model approaches for credit risk, Article 166(8)(d) provides for the determination of the exposure value of "other credit lines" that are not subsumed under more specific definitions of "credit lines" in letter (a), (b) or (c) of that paragraph.
All off-balance sheet items that cannot be subsumed under Article 166(8)(a) to (d) shall in turn be treated under Article 166(10) CRR.

Since binding proposals for mortgage offers cannot be considered a "credit line", these items should be treated in accordance with Article 166(10) CRR.

With particular regard to the binding proposals pursuant to Article 14(6) of Directive 2014/17/EU, during the period where the consumer can exercise a right of withdrawal ('after the conclusion of the credit agreement' but before funds have been released) or during the reflection period ('before the conclusion of the credit agreement', although the offer is binding on the creditor), binding mortgage proposals qualify for the creditor as agreements to lend, and therefore have to be classified as a medium/low risk item under point (3.)(b)(i) of Annex I CRR, provided that the maturity is less than one year.

Aligned with Basel III finalisation - the CRR3 groups these 2 categories into a single bucket set at 40%. In compliance with the level 1 text, the industry is planning on using this CCF for such financing commitments. To note this analysis is also based on the changes induced by the 2017 Basel agreements (see Appendix 1) where these categories were merged into a single 40% CCF bucket.

Indeed, the definition of a commitment brought by CRR3 relies on the acceptance of a contractual arrangement by the client and Article 111.4 specifically aims at specifying that, even if not yet accepted by the client, the item should be treated indifferently as a commitment. There is no intent here to impact the CCF that is to be applied to the given type of commitment as per Annex I.

Question 4. What is the average acceptance rate by the client of a mortgage loan offered by the bank?

We refer to our comments under Q3.

To note that regardless of statistical average, the application of a 100% CCF ahead of acceptance, and even ahead of drawing once the mortgage offer is accepted, is potentially incoherent with the legal framework of some jurisdictions, which do not require acceptance and gives the customer full choice on whether to draw on the offer. It should therefore be viewed as being more akin to a commitment until drawn.

For example, in other jurisdictions (as per transposition of the Mortgage Credit Directive):
i) once the offer is made by the bank, the client has 30 days to accept it (meaning there may also be contingency in relation to the fact that the client does not accept another offer from another bank (as acknowledged by the EBA)
ii) once accepted, the client can still revoke the contractual agreement (without penalty), should the real estate sale not occur.

Therefore from our perspective, bucket 3 is the relevant bucket as specified by CRR3 Annex I.

A 100% CCF means that every offer made by a bank will be accepted by every client and will be subsequently drawn. As a result, all banks contacted by the client, within its legal right to compare different offers, would consume capital for a single mortgage. This demonstrates that the average acceptance rate is under 100%. Hence, a 100% CCF is disproportionate, and does not reflect the actual risk of institutions. The customer's right to compare means that there is no certainty on the final acceptance, so the CCF should not be 100%. It is our understanding of level 1 text, that the intention of the regulator is to assign a CCF to these offers, but not 100%. This interpretation would also comply with the EBA Q&A 2022_6602.

Question 5: Do you have any comment on the allocation criteria proposed under Article 1?

Art.1.1 : "Off-balance sheet items not already included in Annex I to Regulation (EU) No 575/2013 shall be assigned to the bucket 1 referred to in that Annex where the institution's exposure to the risk of credit losses in the event of default of the obligor is not contingent to any non-credit risk related event"

In relation to the drafting of Article 1.1, we believe that this is too broad and could potentially capture any off balance-sheet item not linked to a non-credit related event (such as a financing commitment or revolving credit facility, whereas EBA list of examples correctly assigns such item to bucket 3). In order to better focus the requirements on the items we think the EBA is actually targeting (such as credit substitute guarantees, we would recommend the modification of Article 1.1 to make its application specific to these off-balance sheet items in the form of contingent commitments– i.e. finance guarantees.

This would be in line with the Basel Framework, which in 2017 stated: "A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF." By considering that undrawn loan/ financing commitments such as term loans or revolvers could get higher CCF than 40%, EBA would be deviating from both the intent of the Basel text and the intent of the CRR3 Level 1 text.

Indeed, for many financing commitments (revolving credit facilities, overdrafts), the exposure to credit losses in case of default is not contingent to a non-credit risk related event but to a drawdown which is far from being certain. However the EBA further states in Article 1.2 (see below) that drawing from a commitment shall not be considered as a non-credit risk related event. Therefore undrawn parts of loan commitments where the only event exposing the bank to a credit loss in case of default is the drawdown subject to client's need of funding would fall in the 100% bucket. This simply ignores the concept of CCF as a probability of drawing that is on the contrary well captured by a 40% CCF. An EBA clarification on the fact that the off-balance sheet items at stake under Q1 are only those in the form of contingent commitments (guarantees issued) would avoid any misinterpretation.

The EBA consultation assigns off-balance sheet items to 50% CCF where the institution's exposure to the risk of credit losses in the event of obligor default is contingent to at least one non-credit risk related event that has yet to occur. However, in relation to non-credit related events referred to in RTS Article 1(1), we note that there is a risk that the EBA text would assign certain performance bonds to bucket 1, in the event that the performance of a service was viewed as a credit risk related event. From our perspective, it is not clear how such a scenario could arise. The failure in the fulfilment of a contractual obligation is a first order non-credit risk related event, even if it might be concomitant to the default of the obligor. For instance a performance bond, whereby the issuer ensures the due delivery of goods or services to the buyer, can only be called if the seller has failed to properly finalize the production/delivery. This type of item shall remain treated as a performance bond in bucket 2 or 4 when relevant, as already included in Annex I, even if this failure could be, amongst other potential reasons, linked to financial distress. To avoid any misinterpretation, EBA should specifythat a failure in a contractual obligation should not be perceived as a credit-risk related event.

Art.1.2. Off-balance sheet items not already included in Annex I to Regulation (EU) No 575/2013 shall be assigned to the bucket 2 referred to in that Annex where the institution's exposure to the risk of credit losses in

the event of default of the obligor is contingent to at least one non-credit risk related event that has yet to occur. Where all the non-credit risk related events have occurred, the item shall be assigned to the bucket 1. Drawing from a commitment shall not be considered as a non-credit risk related event for these purposes.

The current phrasing of Article 1.2 may lead to the inclusion of any loan/ financing commitments which give rise to an exposure to credit losses in case of default after a drawing has been done, due to the materialization of a non-credit risk related event (such as administrative compliance, and proof of work achievement). For instance, work-in-progress loans/constructions loans in the Corporate asset class, where the granting of additional drawings in subsequent tranches are conditional to specific fulfilment of control and covenants set out by the bank. As a result, subsequent drawings should not fall into another bucket than bucket 3, on the basis that their payment is effectively dependent on a non-credit event, i.e. the progression of the build. Furthermore, many contracts include words to the effect that subsequent drawings are not at the client discretions but subject to bank approval in relation to the fulfilment of specific conditions. As such our understanding is that this credit line cannot fall into a higher bucket than for non-conditional financing commitments (i.e. 40%). Again, an EBA clarification on the fact that the off-balance sheet items at stake under Article 1.2 are those in the form of contingent commitments (guarantees) would avoid potential misinterpretation.

We want to highlight that the wording "*Drawing from a commitment shall not be considered as a non-credit risk related event for these purposes.",* while creating uncertainty around allocation of undrawn financing commitment to bucket 1 (see above), is also the source of potential misunderstanding when it comes to contingent commitments in the form of guarantees, and more specifically for commitments to issue these off-balance sheet items (that are undrawn commitments). CRR article 111.3 is already providing for a clear treatment for commitments to issue off balance sheet items: one must apply to the part not yet used the minimum between the CCF that applies to the off-balance sheet item to be issued (ruled by EBA proposal) and the CCF of a general commitment which is 40%. The reason being that there is here a double contingency before being exposed to credit losses and this cannot be superseded- as defined by the level 1 text. We are therefore of the opinion that the last sentence of Art.1.2 should be deleted while clarifying that the off-balance sheet items targeted by Art. 1 are only the issued contingent commitments (i.e. guarantees) as already requested above.

Buckets 1 and 2 should not cover loan/ financing commitments since they are already listed in bucket 3 of Annex I and it would be appreciated that EBA strengthens its statement by clarifying that the off-balance sheet items at stake for Article 1.1 and 1.2 are not the undrawn part of loans but contingent commitments issued by banks.

Art. 1.3. Commitments whereby the client must draw certain amounts in the future shall be assigned to the bucket 1 referred to in Annex I to Regulation (EU) No 575/2013 within the limits of those amounts

Bucket 1 relates to contingent commitments (guarantees) and not to financing commitments, which according to level 1 text, go to bucket 3 (40%). Art 1.3 should focus only on guarantees.

The EBA proposes an allocation in bucket 1 to contractual arrangements not yet accepted by the client. We believe that undrawn mortgage loans (accepted or not) should not receive a 100% CCF because they are financing commitments (bucket 3 in Annex 1). Also, please note that clients generally have different offers, which includes legal delays of retractation and because the drawdown is also conditional to the acquisition of the property and therefore is not certain.

The definition of a commitment brought by CRRIII relies on the acceptance of a contractual arrangement by the client and Article 111.4 CRR3 specifically aims at specifying that, even if not yet accepted by the client, the item should be treated in all cases as a commitment. There is no intent here to impact the CCF that is to be applied to the given type of commitment as per Annex I.

That would mean, mortgage loan offers, as well as all other financing commitment, should therefore be assigned to bucket 3 "Commitments", regardless of the maturity of the underlying facility, unless they fall under another category (i.e. where accepted and undrawn mortgage loans are currently assigned by CRRIII in accordance with the Basel standard).

Therefore, we consider Article 1.3 is very likely to exceed the EBA's legal mandate, considering that commitments are already covered by Annex I, as per article 111(4) CRR3 which linked the CCF to Article 111(2) CRR3:

- Article 111(4) CRR3: "Contractual arrangements offered by an institution, but not yet accepted by the client, that would become commitments if accepted by the client, shall be treated as commitments and the percentage applicable shall be the one provided for in accordance with paragraph 2"
- Article 111(2) CRR3: "The exposure value of an off-balance sheet item listed in Annex I shall be the following percentage of the item's nominal value after the deduction of specific credit risk adjustments in accordance with Article 110 and amounts deducted in accordance with Article 36(1), point (m): (a) 100 % for items in bucket 1; (b) 50 % for items in bucket 2; (c) 40 % for items in bucket 3; (d) 20 % for items in bucket 4; (e) 10 % for items in bucket 5".

Therefore, we suggest deleting Article 1.3 of the proposed RTS, as it would be already covered by CRR3, therefore out of scope of the EBA's legal mandate for developing the RTS.

In case the EBA considers the Article should be retained, we would suggest redrafting Article 1.3 to properly assign a bucket 3 for any kind of commitments (including any loan mortgage offers). and specify a different CCF for contingent commitments only (guarantees) according to annex 1 CCF levels.

In relation to items with contractual drawing obligations where the client must draw, referred to in the RTS Article 1(3), the EBA consultation refers to 100% CCF for items where the client must draw certain amounts in the future, and provides the examples of mortgage loan offers not yet accepted and forward starting loans (paragraphs 16 and 17). We already mentioned in our responses to questions 2 and 3 that this should not apply to mortgage offers.

We would like to underline that as for other term loans which fall under bucket 3, construction loans for project finance are to be assigned to this 40% bucket. This point was also made in our response to question 1. We are of the view that subsequent drawings, when they are dependent on progression of construction, should fit into the CCF 40% bucket as well.

Art. 1.4. Unconditionally cancellable commitments shall be assigned to the bucket 3 referred to in Annex I to Regulation (EU) No 575/2013 where their cancellation is constrained by at least one of the factors referred to in Article 2.

The CRR3 mandate in Article 111(8) requires the EBA to develop draft RTS to specify "(…) (b) the factors that may constrain the institutions' ability to cancel the unconditionally cancellable commitments referred to

in Annex I". However, it appears that the draft RTS would result in the introduction of factors (reputational risks, risk management capabilities) that would require banks to increase the CCF from 10% to 40% for potentially most products as currently drafted. Article 1.4 therefore only works if Article 2 is worded in such a way that it only applies to the very few transactions which are economically equivalent to higher CCF than the 10%. We have provided drafting suggestions for Article 2 that makes Article 1.4 workable. We would like to repeat that without changes to Article 2, we do think that Article 1.4 could be used to have a potentially unintended effect. . For instance, a UCC which is also a trade finance item would be forced to be subject to a 40% CCF based on the EBA proposal, whereas there is no reason for preventing this from benefitting of a 20% CCF. No single mandatory CCF should be imposed because of failures in regards of the constraining factors.

Question 6. Do you have any suggestion regarding allocation criteria for buckets 4 and 5?

We note that EBA has not proposed any criteria for the allocation of commitments to the lowest buckets 4 or 5, while it has proposed criteria for the allocation to bucket 1 or 2. Therefore we suggest the EBA to use the items already assigned by national competent authorities to the buckets 4 and 5. The French ACPR and BaFin have, for years, disclosed a list of type of off-balance sheet items assigned to these categories.

We think it would be helpful if the EBA could make it clearer how this links to additional changes under Q9 – i.e. how can these criteria evolve as markets/ risks evolve?

Question 7: Do you have any comment on the factors that may constrain unconditionally cancellable commitments proposed under Article 2?

In relation to the draft RTS Article 2(b), the EBA consultation introduces new factors to be assessed which may constrain banks' ability to cancel the commitment in practice: e.g. commercial considerations aimed at avoiding negative impacts on the creditworthiness of obligor or litigation risks. However, the application of the same policy principle based on this EBA guidance would result in less products qualifying for 10% CCF and instead a higher CCF would have to be applied. We would therefore recommend clearer factors, particularly as these new additional factors would be difficult to assess prior to default.

As already stated, we would like to underline that some factors proposed by the EBA are precisely the one used by the Basel Committee to justify the CCF increase from 0% to 10%[1]. Therefore, the current 10% CCF for UCC already incorporate a risk of drawdown. By reusing those factors to justify an increase from 10% to a higher 40% could simply lead to a double counting (unless linked to additional risks that are specific to a transaction) and we note that a CCF set at 10% already assumes that some UCCs may not always be cancelled.

We believe that these factors as currently drafted are too discretionary and subjective, and potentially institutions will never be able to demonstrate that they objectively don't exist, which creates regulatory uncertainty for institutions in case supervisors have a different views from banks.. We therefore suggest EBA to clarify that its expectations are not that banks should demonstrate, for a given facility or type of facility, that these factors don't exist but instead banks would have to consider assigning a UCC facility to a higher

[1] "*However, consumer protection laws,* ***risk management capabilities and reputational risk considerations*** *may constrain banks' ability to cancel such commitments. For this reason, the Committee believes a 0% CCF is inappropriate and proposes a new CCF of 10% for such exposures.*"

bucket if they identify that these factors apply in a proportionate way. We therefore would emphasize that the EBA needs to better articulate the specification and assessment of the proposed factors.

In particular, we do not think that the possibility (but not certainty) of a reputational consideration at the moment of offering, or entering into, the relevant contractual arrangement, should be sufficient to confirm that the bank is fully committed – therefore we think that factor c) should be deleted. Even more so because it is already encompassed in the 10% CCF. In addition, we also do not think that a litigation factor d) should be included on the list, considering that this is an ever-present risk. We note that reputational and litigation risks are already captured by Pillar 2 within the Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing under Directive 2013/36/EU.4. In addition, we would point out that the condition d) referring to litigation risk appears to be already covered through the updated definition of operational risk in the CRR3 text Article 4(52):
"*operational risk" means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including* ***, but not limited to,*** *legal risk, model risk and ICT risk,*
but ***excluding*** *strategic and reputational risk*;"

Moreover, we are of the view that a contract giving a bank an unconditional right to withhold payment under a commitment is even stronger than the one suggested here, and should therefore also be acceptable.

We therefore believe that the appropriate treatment would be the application of a general 10% CCF (as originally proposed by the BCBS), except for very narrow instances where the intention is to hold the risk of a higher CCF.

In relation to the current factor a) focusing on risk management procedures, we think that this is too broadly phrased at the moment and want to recall that it is generally already included in the 10% CCF by the Basel standard. It is also noteworthy that deficiencies in the risk management procedures are also already captured by Pillar II requirements and should thus not affect CCF assignment through an over broad assessment factor. We therefore suggest that factor a) might specifically refer to the risk management procedures in place to identify credit deterioration of the client, in situations where there is a specific UCC commitment that would qualify as such due to automatic cancellation in the event of the client's credit deterioration.

In this context any credit facility that meets the following conditions shall remain allocated to bucket 5: a) it contractually provides for cancellation in case of client's creditworthiness deterioration; and b) is subject to a risk management process which allows that the credit deterioration is detected in a timely manner and that there is no substantial time lag between the observed deterioration and the cancellation of the line. Other situations may be seen as not being automatically eligible situations. Moreover, a contract that could be automatically cancelled in case of liquidation only would not meet the condition, since the credit deterioration allowing for cancellation is too specific to constrain drawing and thus to justify a low likelihood of drawing over the one-year period prior to default.

Similarly in relation to the factor b) referring to commercial considerations, we think that this again is too broadly phrased and should instead be revised to refer to an internal decision made by the institution that it is highly likely to pay out due to specific client credit-worthiness considerations (as potentially referenced in the institution's formal ICAAP/ ILAAP documentation). We recommend that the EBA consider the guidance contained in the ECB Guide to Internal models 2024 (EGIM2024:
SSM.supervisory_guides202402_internalmodels.en, Article 166(8) a & c), which refers to the 'financial

condition of the obligor and their internal control systems…', in order to 'deterioration in the credit quality of the obligor.'

Question 8. Do you have any comment on the notification process proposed under Article 3?

In relation to reporting referred to in RTS Article 3, we note that in the CRR3 COREP consultation, there is no detailed guidance how to report these 'other off-balance sheet items' (Template C07.00 is the only form where there are different buckets of SA-CCFs (0, 10, 20, 40, 50, 100, other) under which exposures can be reported).

Moreover, there is no opportunity to explain a bank's rationale on why other off-balance sheet items are assigned to the specific bucket. Therefore, we recommend that more clarity is provided in relation to the reference to reporting as per COREP. Or as an alternative, each bank might report its 'other' off-balance sheet items to its competent authority, together with a rationale why this product is assigned to this bucket = the competent authority would then report these types of 'other' off-balance sheet items to the EBA. The EBA should then publish the assignment of all 'other' off-balance sheet items reported to them with their view for the right assignment, to ensure that products with the same features were assigned to the same bucket across the Single Market, thereby ensuring a level playing field for institutions.

Question 9. For credit institutions:

- What is the materiality in your institution of the off-balance sheet items that would fall under the categories "Other off-balance sheet items carrying similar risk and as communicated to EBA" listed in each bucket of Annex I?
- Do you identify any specific item you may hold off-balance sheet that is currently classified as "Other off-balance sheet items carrying similar risk and as communicated to EBA" and that may experience a change in bucket allocation based on the criteria listed in Article 1 of these RTS? What would be the related change in the associated percentage as per article 111(2)

We do not think that the process referred to by the EBA is sufficiently clear, and therefore the EBA needs to provide firms with further guidance on how this process is intended to work. By giving clearer guidance, the EBA could significantly help firms in establishing when it is appropriate to view a product as falling into a specific risk category. It would also be helpful to clarify how the EBA envisages this process to be related to the Q&A process, given that the Q&A processes do not work with confidentiality issues that arise for specific products. Similarly, it would be helpful to understand the scope the EBA intends. For example, is this viewed by competent authorities to be available at a granular transaction level, where legal contracts could be specifically designed to reduce risk to another bucket, or is it more intended for more general product types. It is also not clear what the role of the National Competent Authority would be as part of this process.

As illustration, in some jurisdictions, the local Competent Authority has published guidance on some items such as technical guarantees generating exposure to credit losses conditional to the non-fulfilment of contractual obligations that are today listed as of similar risk of trade finance exposure. These may fall into 50% bucket based on article 1 and as mentioned the EBA mandate is not to deviate from the approved Level 1 text. If we take the example of the French authority, they have published a list of off-balance sheet facilities that they consider carrying similar risk as the different bucket of Annex I. As already explained, the list of instruments of bucket 4 (20% CCF) in the new Annex I has not changed compared to the current CRR2

(except for commitment depending on their initial maturity), therefore this list provided by the French authorities should not change.

Overall, we suggest that the process of assignment should not be too prescriptive to allow firms to adapt to changes in the marketplace.

Appendix 1: Comparison between the 2017 Basel agreements and the 2006 Basel agreements

As shown in the tables below, the 2017 Basel agreement (Basel III finalisation) has made only one change to the 2006 Basel (Basel II) allocation of OBS items: Commitments depending on original maturity (including agreement to lend) allocated to former bucket 2 and 3 have been merged into a unique and new bucket at 40%. Other bucket allocations have not been modified by the final Basel 3 agreement.

	December 2017 Agreement	June 2006 Agreement	Status
	A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF	Commitments with an original maturity up to one year and commitments with an original maturity over one year will receive a CCF of 20% and 50%, respectively. However, any commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, will receive a 0% CCF.33	**Change**

	December 2017 Agreement	June 2006 Agreement	Status
100%	Direct credit substitutes, eg general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).	Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) will receive a CCF of 100%.	**No change**
	Sale and repurchase agreements and asset sales with recourse where the credit risk remains with the bank.	Sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank will receive a CCF of 100%.	**No change**
	The lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (ie repurchase/reverse repurchase and securities lending/securities borrowing transactions). The risk-weighting treatment for counterparty credit risk must be applied in addition to the credit risk charge on the securities or posted collateral, where the credit risk of the securities lent or posted as collateral remains with the bank. This paragraph does not apply to posted collateral related to derivative transactions that is treated in accordance with the counterparty credit risk standards.	A CCF of 100% will be applied to the lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions). See Section II.D.3 for the calculation of risk-weighted assets where the credit converted exposure is secured by eligible collateral.	**No change**
	Forward asset purchases, forward forward deposits and partly paid shares and securities,55 which represent commitments with certain drawdown.	Forward asset purchases, forward forward deposits and partly-paid shares and securities35, which represent commitments with certain drawdown will receive a CCF of 100%.	**No change**
	Off-balance sheet items that are credit substitutes not explicitly included in any other category.		

	December 2017 Agreement	June 2006 Agreement	Status
50%	A 50% CCF will be applied to note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility.	Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) will receive a CCF of 50%.	**No change**
	A 50% CCF will be applied to certain transaction-related contingent items (eg performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) will receive a CCF of 50%.	**No change**

	December 2017 Agreement	June 2006 Agreement	Status
20%	A 20% CCF will be applied to both the issuing and confirming banks of short-term56 self-liquidating trade letters of credit arising from the movement of goods (eg documentary credits collateralised by the underlying shipment).	For short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), a 20% CCF will be applied to both issuing and confirming banks.	**No change**

	December 2017 Agreement	June 2006 Agreement	Status
100%	Direct credit substitutes, eg general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).	Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) will receive a CCF of 100%.	No change
	Sale and repurchase agreements and asset sales with recourse where the credit risk remains with the bank.	Sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank will receive a CCF of 100%.	No change
	The lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (ie repurchase/reverse repurchase and securities lending/securities borrowing transactions). The risk-weighting treatment for counterparty credit risk must be applied in addition to the credit risk charge on the securities or posted collateral, where the credit risk of the securities lent or posted as collateral remains with the bank. This paragraph does not apply to posted collateral related to derivative transactions that is treated in accordance with the counterparty credit risk standards.	A CCF of 100% will be applied to the lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions). See Section II.D.3 for the calculation of risk-weighted assets where the credit converted exposure is secured by eligible collateral.	No change
	Forward asset purchases, forward forward deposits and partly paid shares and securities,55 which represent commitments with certain drawdown.	Forward asset purchases, forward forward deposits and partly-paid shares and securities35, which represent commitments with certain drawdown will receive a CCF of 100%.	No change
	Off-balance sheet items that are credit substitutes not explicitly included in any other category.		

	December 2017 Agreement	June 2006 Agreement	Status
50%	A 50% CCF will be applied to note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility.	Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) will receive a CCF of 50%.	No change
	A 50% CCF will be applied to certain transaction-related contingent items (eg performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) will receive a CCF of 50%.	No change

	December 2017 Agreement	June 2006 Agreement	Status
20%	A 20% CCF will be applied to both the issuing and confirming banks of short-term56 self-liquidating trade letters of credit arising from the movement of goods (eg documentary credits collateralised by the underlying shipment).	For short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), a 20% CCF will be applied to both issuing and confirming banks.	No change

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