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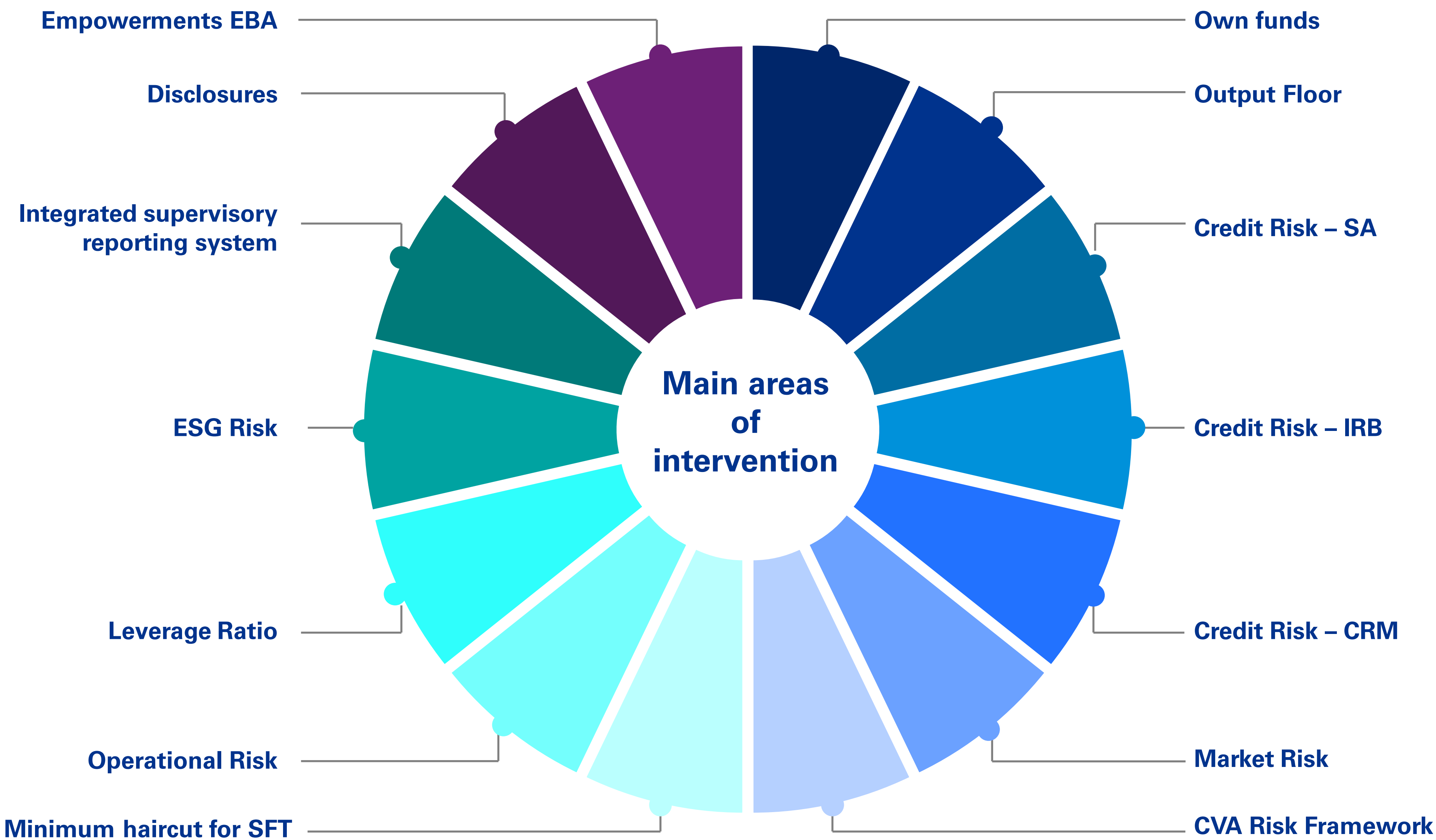
Basel 4: European Commission proposal for CRR3

November 2021

Agenda

1. CRR3: Main changes a novelties in a nutshell



Implementing Basel 4 - European Commission proposal for CRR3

On 27 October 2021, the European Commission published its 2021 Banking Package designed to strengthen banks' resilience and better prepare for the future. There are **three parts** to the package:

1. **Implementing** the final **Basel reforms** (Basel 4)
2. **Sustainability** - contributing to the **green transition**
3. **Stronger supervision** - ensuring **sound management** of EU banks and protecting **financial stability**

The **first part** is covered in the **Commission's proposal for key amendments to the Capital Requirements Regulation**, referred to as **CRR3**. These relate to credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor and will be the basis for implementing the remaining Basel 4 requirements in the EU.

Why are further amendments required?

While the overall level of capital in the EU banking system is now generally considered satisfactory, **there were still issues to address around the use of internal models and underestimation of risk**. These issues are addressed by the Basel 4 requirements.

CRR3 is intended to implement faithfully the Basel 4 requirements, while taking into account the specific features of the EU's banking sector. It aims to **ensure that internal models used by banks to calculate their capital requirements do not underestimate risks**, thereby ensuring that the **capital required** to cover those risks **is sufficient**. This will make it easier to compare risk-based capital ratios across banks and should, in turn restore confidence in the ratios and the soundness of the sector overall.

The proposal aims to strengthen resilience, without resulting in significant increases in capital requirements. The Commission notes that it limits the overall impact on capital requirements to what is necessary, in order to maintain the competitiveness of the EU banking sector. **The package also aims to reduce compliance costs**, particularly for smaller banks, without loosening prudential standards.

In line with expectations?

The EU has given more time to implement the final Basel reforms. The Commission proposes to **start implementing the new rules from 1 January 2025**, two years later than the (already deferred) 1 January 2023 Basel Committee timeline.

As widely expected, the **Commission has rejected the "parallel stacks approach"** in relation to the output floor. CRR3 introduces **the output floor through a "single stack" approach** but with safeguards to avoid duplication in capital requirements.

In a predicted deviation from Basel 4, CRR3 introduces an amendment that **the `floored' total risk exposure amount be applied at the highest level of consolidation in the EU**.

The proposals also make use of **flexibility** elsewhere in the framework **to keep capital increases to a minimum.**

And CRR3 also introduces **harmonised definitions of the different types of ESG risks**. Banks are now required to identify, disclose and manage these risks at an individual level and report their exposure to the competent authorities. However, no immediate increase in capital is required.

European Commission proposal for CRR III

Risk Management Framework

Credit Risk

Standardized Approach (SA):

Complexity

Impact

- Revision of the SA for credit risk to increase risk sensitivity in relation to several key aspects, including:
  - Updates to the way institutions determine their exposure value of off-balance sheet items and commitments on off-balance sheet items – in particular, by amending credit conversion factors (CCFs)
  - Basel 4's Standardized Credit Risk Assessment Approach (SCRA) is introduced to sit alongside the existing External Credit Risk Assessment Approach (ECRA) – with implications for exposures to institutions and corporates
- General alignment to Basel 4 risk weighting amendments regarding the treatment of: specialised lending exposures, retail exposures, exposures with currency mismatch, subordinated debt exposures and defaulted exposures
- CRR3 deviates from Basel 4 slightly regarding exposures secured by real estate – where Basel 4 caps property value at loan origination, CRR3 maintains the EU's use of frequent monitoring and adjustments
- CRR3 deviates from Basel 4 regarding equity exposures - by introducing specialised treatment for strategic equity investments

Internal Ratings-Based approach (IRB):

Complexity

Impact

- New limitations to the exposure classes for which internal models can be used to calculate own funds requirements:
  - Exposures to corporates with total sales greater than EUR 500 million, institutions and financial sector entities can only use Foundation IRB (F-IRB) and no longer use Advanced IRB (A-IRB)
  - Equity exposures can only use SA-CR and no longer use IRB
- Introduction of an input floor under A-IRB to include minimum values for institutions' own estimates of IRB parameters that are used as inputs to the calculation of RWAs
- General alignment to other Basel 4 amendments relating to IRB risk weights – with CRR3 applying only the following deviations:
  - Creation of a new exposure class for regional governments and local authorities as well as public sector entities
  - 'Phase in' of parameter floors for specialised lending exposures under the A-IRB approach and including certain transitional arrangements over a 5-year period
- The EBA is tasked with assessing the appropriateness of enabling clauses for leasing exposures and credit issuance

Credit Risk mitigation techniques:

Complexity

Impact

- Rules implemented to account for collateral and guarantees under both the SA-CR and F-IRB approaches

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** Complexity assessment in terms of implementation efforts // Impact assessment in terms of potential effects on Own Fund Requirements*

European Commission proposal for CRR III

Risk Management Framework

Credit Valuation Adjustment Risk

- Amendments to ensure that standards appropriately capture banks' actual CVA risk. Specifically:
  - CVA risk is updated to include both the credit spread risk of a counterparty and the market risk of the portfolio
  - Clarification on which transactions are subject to CVA risk requirements
  - Requirement for institutions to report the results of their calculations for exempted transactions (accounting for any eligible hedges)
  - Description of new approaches for calculating own funds requirements for CVA risk, as well as conditions for using a combination of these approaches

Complexity

Impact

Operational risk

- All existing approaches for the calculation of the own funds requirements for operational risk are replaced by a single non-model-based approach to be used by all institutions. Institutions will still have discretion to use models, such as those developed under AMA, in their ICAAP processes.
- Basel 4's standardized approach combines an indicator based on an institution's business size (Business Indicator Component) with an indicator based on loss history, but allowed for jurisdictional discretion on how the loss indicator was implemented. CRR3 uses this discretion to set minimum own funds requirements for operational risk based solely on the BIC.
- As a matter of proportionality, data collection and governance rules are split into those applying to all institutions and those only relevant for institutions that also have to disclose historical loss data (i.e., those with a business indicator equal to or above EUR 750 million)

Complexity

Impact

Market risk

- In line with Basel 4's revised FRTB standards, binding own funds requirements for market risk are introduced. FRTB approaches – alternative standardized approach (A-SA), alternative internal model approach (A-IMA) and simplified standardized approach (SSA) – are introduced along with their conditions for use, and the frequency of calculation of the own fund's requirements.
- Most notably, existing internal model approaches to calculate own fund requirements are replaced with the FRTB A-IMA.

Complexity

Impact

** Complexity assessment in terms of implementation efforts // Impact assessment in terms of potential effects on Own Fund Requirements*

European Commission proposal for CRR III

Risk Management Framework

Output floor

- An output floor is introduced to reduce the variability of own funds requirements calculated using internal models. This floor sets a lower limit to the capital requirements produced by internal models – once fully implemented, this will be 72.5% of the own funds requirements that would apply under standardized approaches
- In a deviation from Basel 4 however, CRR3 introduces an amendment that the ‘floored’ total risk exposure amount (TREA) be used only by the institution at the highest level of consolidation in the EU. Nonetheless, any consequent increase in the own funds required must be distributed fairly across the subgroups which are located in other member states, according to their risk profile

Complexity

Impact

Leverage Ratio

- Adjustment of the total exposure measure to align the treatment of client-cleared derivatives with the treatment envisaged under the standardized approach for counterparty credit risk
- Removal of minimum conversion factor of 10% for certain off balance-sheet items
- Clarification that certain provisions (related to regular-way purchases and sales awaiting settlement) apply to financial assets, rather than only securities

Complexity

Impact

Minimum haircut floor framework for Securities Financing Transactions (SFTs)

- Basel 4 proposes the introduction of minimum collateral haircuts for some non-centrally cleared SFTs, and that these haircuts be introduced indirectly via a punitive capital requirement
- Before including this in CRR3, the EBA and ESMA have been tasked with reporting on the implications of the haircuts and whether they should be implemented punitively or as a blanket market regulation

Complexity

Impact

** Complexity assessment in terms of implementation efforts // Impact assessment in terms of potential effects on Own Fund Requirements*

Agenda

General provisions: definitions

- The CRR3 proposal provides modifications to the Part One (*General Provisions*) of the Regulations, articulated in Title I (*Subject Matter, Scope and Definitions*) and Title II (*Level of application of requirements*)
- The summary reported below covers both general definitions (Article 4) and definitions which are specific to capital requirements for credit risk (Article 5)

Summary of main intervention

Definitions

General definitions - Art. 4

List of both revised and new (in bold) definitions is reported below:

- **Control Structure**: parent undertaking, subsidiary, ancillary services undertaking
- **Firm/Institution Segmentation**: financial/ pure industrial holding company, **investment holding company** and financial institution
- **European membership:** parent and stand-alone subsidiary institution in a Member State, stand-alone institution in the EU
- **Risks:** operational risk, **legal, model, ICT, ESG** (including **environmental, physical, transition, social, governance**) risks
- **Credit risk:** PD, LGD, CCF and **realized CCF**
- **Credit risk mitigation**: Funded and Unfunded Credit Protection (FCP - UFCP), cash assimilated instrument and **gold bullion**
- **Properties: property value**, residential property, **commercial immovable property, income and non-income producing real estate** (IPRE and non-IPRE), **non-ADC** exposure and related secured exposures
- **Others:** Revolving and Transactor exposures, Indirect/Synthetic holding, Trading Desk, 1Y Default Rate

Credit Risk specifics - Art. 5

- Revised definition of **Expected Loss**, specifying that the loss should be intended as a ratio with respect to the amount outstanding at default (or at dilution event)
- New definitions are summarized below**:**
  - **Credit obligation:** obligation which includes principal, accrued interest, fees owed to the institution or to a third party
  - **Credit exposure:** any on-balance (principal, accrued interest and fees) and off-balance items due to a credit obligation
  - **Facility:** credit exposure arising from contract(s)
  - Margin of Conservatism (**MoC**): additive or multiplicative add-on incorporated in risk estimates to account for errors deficiencies in data/methods, changes to processes and estimation error
  - Small and medium-sized enterprise (**SME**): company which has a consolidated annual turnover below € 50 mln[1]
  - **Commitment:** contractual arrangement to extend credit, purchase assets or issue credit substitutes (a list of conditions under which it is not considered a commitment is provided)
  - **Unconditionally cancellable commitment:** a commitment that may be cancelled at any time or automatically in case of diminished credit worthiness

1. In Article 501 (SME supporting factor), the SME definition is amended accordingly

General provisions: level of application of requirements

- The CRR3 proposal provides modifications to the Part One (*General Provisions*) of the Regulations, articulated in Title I (*Subject Matter, Scope and Definitions*) and Title II (*Level of application of requirements*)
- As summarized below, the modifications are mainly related to the application of the requirement at consolidated level

Summary of main intervention

Level of application of requirements

- Among the general principles (Article 6), it is specified that the requirement introduced by the **output floor** should **not** be applicated **at individual level** in any case (amendment to paragraph 3)
- Article 10a is amended, specifying the conditions under which **investment firms and investment holding companies** shall be considered **parent financial holding**
- Article 11 is amended as well, detailing how a Parent Institutions in the a Member State shall comply at consolidated level with requirements on output floor (Article 92(3)) and disclosure (Article 430(1))
- The **method for prudential consolidation** disciplined in Article 18 are modified, in particular:
  - Paragraph 7, providing the conditions under which it should be applicated the equity method, is amended removing the reference to ancillary services undertakings
  - Inserted paragraph 10, mandating to EBA to assess any discrepancies in the provisions set out in the Regulation and interactions with applicable to accounting framework that may result in constraints to consolidated supervisions
- The Article 20, on the **cooperation between competent authorities in case of applications submitted by parent and subsidiaries**, is amended, in particular:
  - To take into account the revised framework for operational risk
  - On the application of the IRB approach for credit risk in parent and subsidiaries, which should be consistent with group structure, risk management systems, process and methodologies

Own funds and Output Floor

For the purposes of own funds requirements calculation, the total risk exposure amount (TREA) shall be determined according to one of the following methodologies

A

- Stand-alone institution in the EU
- EU parent institution[(a)]

$$\boldsymbol{TREA} = \max\{\, \boldsymbol{U-TREA}; \boldsymbol{x} \cdot \boldsymbol{S-TREA}\}$$

$\boldsymbol{U-TREA}$ = the un-floored total risk exposure amount
$\boldsymbol{S-TREA}$ = the standardised total risk exposure amount
$\boldsymbol{x}$ = Output floor = **72,5 %** or the factor foreseen by the transitional arrangements (see slide 12)

For more details on the U-TREA and S-TREA calculation, please see slide 13

B

- Stand-alone subsidiary institution in a Member State
- Parent institution in a Member State[(b)]

$$\boldsymbol{TREA_i} = \boldsymbol{U-TREA_i} + \boldsymbol{DI^{conso}} \cdot \boldsymbol{Contrib_i^{conso}}$$

i = denotes the entity
$\boldsymbol{U-TREA_i}$ = un-floored total risk exposure amount of entity i
$\boldsymbol{DI^{conso}}$ = any positive difference between the TREA and the U-TREA for the consolidated situation of the EU parent institution
$\boldsymbol{Contrib_i^{conso}}$ = contribution of entity i

C

- Institution which is neither a stand-alone institution in the EU nor a stand-alone subsidiary institution in a Member State

$$\boldsymbol{TREA} = \boldsymbol{U-TREA}$$

$\boldsymbol{U-TREA}$ = the un-floored total risk exposure amount of the entity

For more details on the calculation of U-TREA see slide 13

Note: (a) an EU parent financial holding company and an EU parent mixed financial holding company
(b) a parent financial holding company or a parent mixed financial holding company in a Member State

Output Floor - Transitional arrangements

In order to mitigate the Output Floor effects on institutions' TREA, the proposal for CRR III provides for several derogations, shown below

For the purpose of S-TREA calculation the following **derogation applies**

- Until 31st December 2032, institutions shall apply a **65%** RW to exposures to corporate for which **no credit assessment** by an ECAI **is available**[(a)]
- Until 31st December 2029 and for the purpose of calculating the **RWEA** for **counterparty** risk arising from **trading book**, institutions could **replace alpha by 1** in determining the exposure value for the contracts listed in Annex II [(b)]

When specific criteria are met, **lower risk weights** could be applied:

- on the part of the exposures secured by mortgages on residential property
- to any remaining part of the exposures secured by mortgages on residential property

Such specific treatment could be applied by institutions only where the Member State exercises the discretion set forth by the proposal for CRR III

Until 31st December 2029, **stand-alone institutions in the EU** and **EU parent institutions,** could apply the following **formula** for the **TREA** calculation

$$TREA = min\{max\{ UTREA; x \cdot STREA\}; 125\% \cdot UTREA\}$$

Institutions shall apply the following **phase-in calendar** for the **output floor**

Year	Output floor
2025	50%
2026	55%
2027	60%
2028	65%
2029	70%
2030	72,5%

Note: (a) if the PD calculated with the IRB approach is not higher than 0,5%
(b) according to the approach set out in this Part, Title II, Chapter 6, Section 6

Output Floor - U-TREA and S-TREA calculation

The U-TREA and S-TREA shall be calculated as follows

U-TREA

The **Un-Floored Total Risk Exposure Amount** is given by the **sum** of the components shown below (using, if applicable, the institution's internal models)

A Risk Weighted Exposure Amount (RWEA)	+	Own Funds Requirements · 12,5 B
CREDIT RISK		MARKET RISK
DILUTION RISK		SETTLEMENT RISK
COUNTERPARTY RISK		CVA RISK
		OPERATIONAL RISK

S-TREA

The **Standardised Total Risk Exposure Amount** is given by the **sum:**

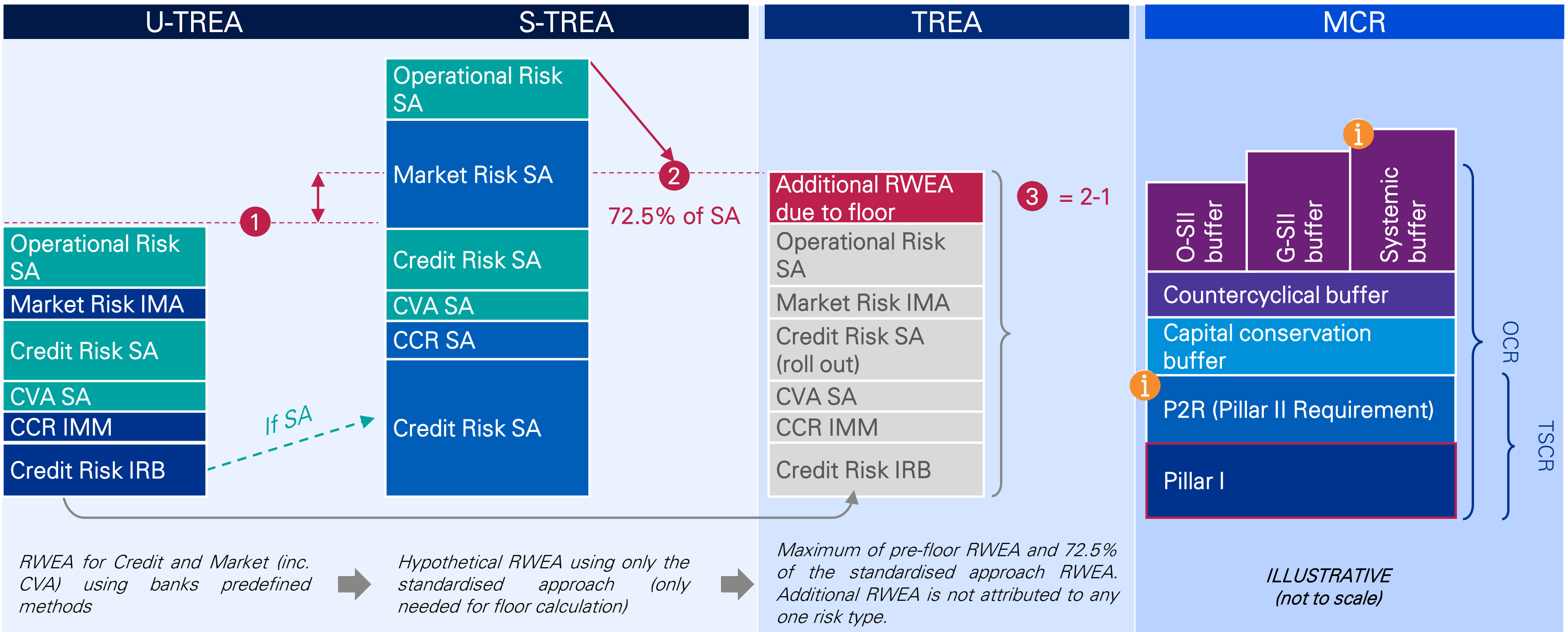
- of the same components of the U-TREA, computed **adopting only the standardised approaches** set forth in the proposal for CRR III and, therefore, meeting the following requirement;

A for point (A) without using (i) the internal models approach for **master netting agreements**; (ii) the **Internal Ratings Based Approach**; (iii) the **Securitization Internal Ratings-Based Approach (SEC-IRBA)** and the **Internal Assessment Approach (IAA)**; (iv) the **IRB-CCF approach**

B for point (B), and with regards to the Market Risk, **without using the alternative internal model approach**

Output Floor - How it works

A visual representation of the functioning of the Output Floor is provided below



Legend: **CCR**: Counterparty Risk **TSCR**: Total SREP capital requirement **OCR**: Overall capital requirement

- Since the **P2R** and the **SyRB** could be used to address **risks** that are **similar** in nature to those **addressed by the OF** (e.g. model risk), the amendments to the CRD IV introduce safeguards aimed at **preventing unjustified increases** in the abovementioned requirement following an institution becoming bound by the OF:
  - the P2R and the SyRB requirement will be "**frozen**" to **avoid automatic increases** in the amount of **regulatory capital required** under those two requirements
  - the **institution's competent authority** will be required to **review** the **calibration** of the **P2R** and of the **SyRB requirements**, in order to re-calibrate them in case double-counting of risk is present. The P2R and the SyRB requirement will remain frozen until the respective reviews will be concluded and the **relevant decisions** on the **appropriate calibration** of the requirements **will be announced** (in the case of the P2R, the announcement will take the form **of a SREP letter)**

Source: Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU and amending Directive 2014/59/EU

Agenda

Overview of the Credit risk - Standardised approach (CR-SA)

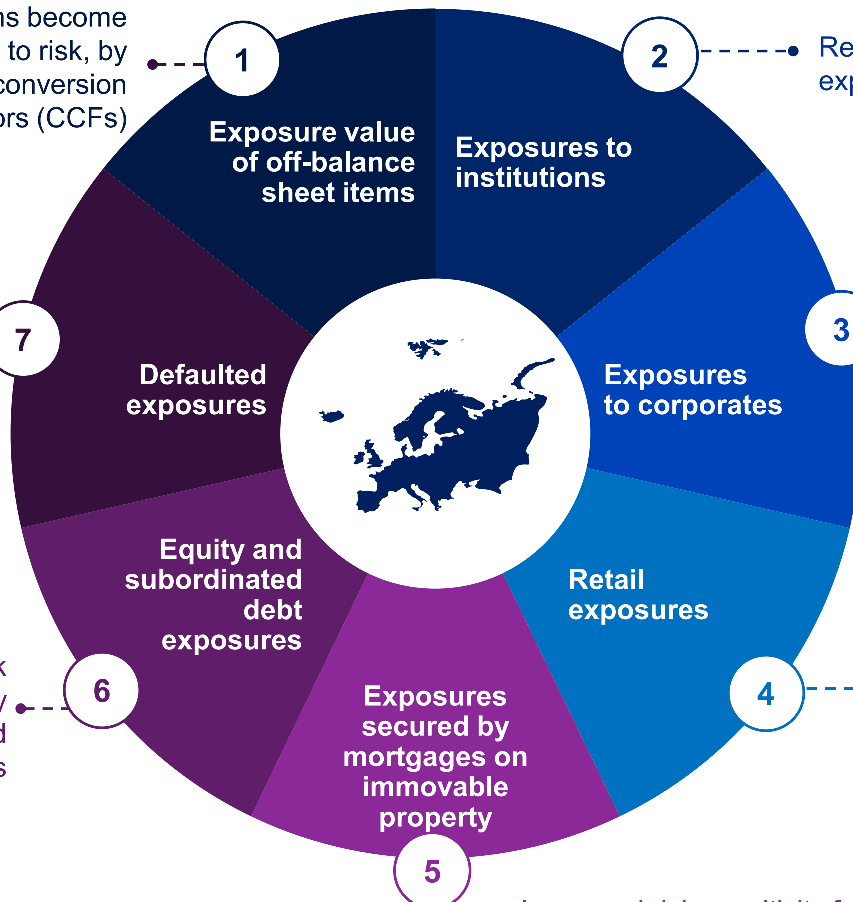
The proposal for CRR III, consistently with the Basel IV provisions, improves the regulatory framework of the standard approach for credit risk:

— Increases granularity and sensitivity to risk

— Reduces the mechanical use of credit ratings

The main changes are:

1. Off-balance sheet items become more sensitive to risk, by modifying credit conversion factors (CCFs)
2. Recalibration of risk weights for exposures to rated institutions
3. More granular value table for exposures to corporates
4. More granular treatment for retail exposures
5. Increased risk sensitivity for exposures secured by mortgages on immovable property
6. More granular risk weights for equity and subordinated debt exposures
7. Clarification on the risk weight treatment of discounts on purchases of non-performing exposures



Credit risk - Standardised approach (SA) (1/11)

1

- Modification of **credit conversion factors** (CCF) used to determine the amount of an exposure that will be weighted by risk, so that they are **more sensitive to risk**, with the introduction of a **positive CCF** for **unconditionally cancellable commitments** (UCC)
- Introduction of **specific definition of commitment** (art. 5)

Exposure value (Art. 111)

AS IS

- The **exposure value** of an **off-balance sheet item** shall be the **following percentage** of its **nominal value** after reduction of specific credit risk adjustments:

Description	RWs
Full risk Item	100%
Medium risk Item	50%
Low / medium risk Item	20%
Low risk Item	0%

Note: the off-balance sheet items falling within the abovementioned categories are listed in Annex I - CRR

TO BE

- The exposure value (EV) of an off-balance sheet item shall be the following percentage of the item's nominal value after the deduction of specific credit risk adjustments and other amounts:

Bucket	Description	RWs
1	Direct credit substitutes and other off-balance-sheet exposures	100%
2	NIF[(a)] and RUF[(b)], and certain contingent items related to specific operations	50%
3	Commitments, except UCC	40%
4	Letters of self-liquidating short-term commercial credit from asset displacement operations	20%
5	UCC	10%

(a) Note Issuance facilities; (b) Revolving underwriting facilities

- The EV of a commitment on an off-balance sheet item as referred above, shall be the lower of the following percentages of the commitment's nominal value after the deduction of specific credit risk adjustments and amounts deducted:

  (a) the percentage of the table above that is applicable to the item on which the commitment is made

  (b) the percentage referred to above, that is applicable to the type of commitment

Note: For contractual arrangements offered by an institution, but not yet accepted by the client, that would become commitments if accepted by the client, and contractual arrangements that would qualify as commitments but meet the conditions for not being treated as commitments, the percentage applicable to that type of contractual arrangement shall be that provided for in accordance with the table above

Credit risk - Standardised approach (SA) (2/11)

2

- Introduction of the **External Credit Risk Assessment Approach** (ECRA) that relies on external credit risk assessments (i.e. credit ratings) provided by eligible credit assessment institutions (ECAIs)
- Introduction of the **Standardised Credit Risk Assessment Approach** (SCRA), under which the exposures to unrated institutions shall be classified into **three different buckets** (or grades)[(a)], based on several quantitative and qualitative criteria

AS IS

Exposure to rated institutions (Art.120)

- Exposures for which a **credit assessment** by a **nominated ECAI** is **available** shall be assigned a risk weight in accordance with the following table

Risk weights for exposures to rated institutions

Credit Quality Step	1	2	3	4	5	6
RWs	20%	50%	50%	100%	100%	150%
Short-term[(b)] RWs	20%	20%	20%	50%	50%	150%

Exposure to unrated institutions (Art.121)

- Exposures for which a **credit assessment** by a **nominated ECAI** is **not available** shall be assigned a risk weight according to the credit quality step to which exposures to the **central government** of the jurisdiction in which the institution is incorporated are assigned in accordance with the following table

Risk weights for exposures to unrated institutions

Credit quality step Central gov.	1	2	3	4	5	6
RWs	20%	50%	100%	100%	100%	150%
Short-term[(b)] RWs	20%					

TO BE

Exposure to rated institutions (Art.120)

- Exposures for which a **credit assessment** by a **nominated ECAI** is **available** shall be assigned a risk weight in accordance with the following table

ECRA - Risk weights for exposures to rated institutions

Credit Quality Step	1	2	3	4	5	6
RWs	20%	***30%***	50%	100%	100%	150%
Short-term[(b)] RWs	20%	20%	20%	50%	50%	150%

Exposure to unrated institutions (Art.121)

- Exposures for which a **credit assessment** by a **nominated ECAI** is **not available** shall be assigned a risk weight in accordance with the following table

SCRA - Risk weights for exposures to unrated institutions

SCRA Grades	Grade A	Grade B	Grade C
RWs	40% [(c)]	75%	150%
Short-term[(b)] RWs	20%	50%	75%

Note: (a) For more details, please see Annex
(b) maturity of three months or less
(c) a risk weight of 30% could be applied if the institution's Common Equity Tier 1 capital ratio is equal to or higher than 14 %; and (ii) the institution's leverage ratio is higher than 5 %

Credit risk - Standardised approach (SA) (3/11)

3

- Introduction of a **lower** the **risk weight** applicable to exposures to corporates for which a **credit quality step 3 credit assessment** by a nominated ECAI is available.

Exposure to corporates
(Art. 122)

AS IS

- Exposures for which a **credit assessment** by a **nominated ECAI** is **available** shall be assigned a risk weight in accordance with the following table

Corporate Exposures - Risk weights for rated exposures						
Credit Quality Step	1	2	3	4	5	6
RWs	20%	50%	100%	100%	150%	150%

- Exposures for which such a credit assessment **is not available** shall be assigned a **100 % risk weight** or the **risk weight of exposures to the central government** of the jurisdiction in which the corporate is incorporated, whichever is the higher.

TO BE

- Exposures to **corporates** shall be assigned a risk weight in accordance with the following table

Corporate Exposures - Risk weights for rated and unrated exposures							
Credit Quality Step	1	2	3	4	5	6	Unrat.
RWs	20%	50%	**75%**	100%	150%	150%	100%

Credit risk - Standardised approach (SA) (4/11)

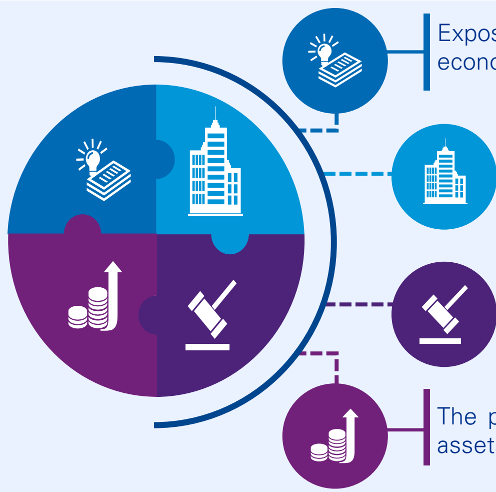
3

- Introduction of an exposures class for **specialised lending exposures** and **two approaches** to determine the applicable RWs, one for externally rated exposures and one for exposures which are not externally rated
- **Project finance**, **object finance** and **commodities finance** exposure classes are introduced under the SA-CR, **in line** with the same three subcategories in the **internal ratings-based** (IRB) **approaches**.

Specialised lending exposures (Art. 122a)

AS IS	TO BE
▪ **N/A**	▪ Within the corporate exposure class, institutions shall **separately identify** as **specialised lending exposures**, based on the following characteristics

Definition - Specialised lending exposures



- Exposure to an entity created specifically to finance or operate physical assets or to an economically comparable exposure
- The exposure is not secured by immovable property nor is related to real estate financing
- The contractual arrangements give the institution a substantial degree of control over the assets and the income that they generate
- The primary source of repayment of the obligation is the income generated by the assets financed

Credit risk - Standardised approach (SA) (5/11)

3

- Introduction of an exposures class for **specialised lending exposures** and **two approaches** to determine the applicable RWs, one for externally rated exposures and one for exposures which are not externally rated
- **Project finance**, **object finance** and **commodities finance** exposure classes are introduced under the SA-CR, **in line** with the same three subcategories in the **internal ratings-based** (IRB) **approaches**.

AS IS | TO BE

Specialised lending exposures (Art.122a)

AS IS

- **N/A**

TO BE

- With regards to **specialised lending exposures** for which a directly applicable **credit assessment** by a nominated ECAI is available, the risk weights shall be assigned in accordance with the following table

Corporate Exposures - Risk weights: specialised lending exposures with an ECAI's credit assessment available					
Credit Quality Step	1	2	3	4	5
RWs	20%	50%	75%	100%	150%

- With regards to **specialised lending exposures** for which a directly applicable **credit assessment** by a nominated ECAI is **not available**, institutions shall assign the risk weights according to the category to which the exposure belongs. Such classification shall be done according to the qualitative criteria set forth by the proposal for CRR III[a]

Corporate Exposures - Risk weights: specialised lending exposures without an ECAI's credit assessment available	
Type of exposure	Risk Weight
Object finance – high quality	80%
Object finance	100%
Commodities finance	100%
Project finance – pre-operational phase	130%
Project finance – operational phase	100%
Project finance – operational phase (and meeting specific criteria) [a]	80%

Note: (a) For more detail, please see Annex

Credit risk - Standardised approach (SA) (6/11)

4

- Alignment of the **classification of retails exposures** under **SA-CR with the classification under the IRB approaches**, in order to ensure a consistent application of the correspondent risk weights to the same set of exposures
- The **CRR III proposal modifies** the **criteria for the identification of retail exposures**

Retail exposures (Art. 123)

AS IS	TO BE
▪ Exposures that comply with **all** of the **following criteria** shall be considered retail exposures: a) the exposure shall be either to an **natural person** or persons or to a **small or medium-sized enterprise** (SME) b) the exposure shall be one of a significant number of exposures with **similar characteristics** such that the risks associated with such lending are substantially reduced c) the **total amount** owed to the institution **shall not exceed EUR 1 million**	▪ Exposures that comply with **all** of the **following criteria** shall be considered retail exposures: a) the exposure is either of the following: ▪ an exposure to one or more **natural persons** ▪ an exposure to an **SME**, where the total amount owed to the institution shall **not exceed EUR 1 million** b) the exposure represents one of a significant number of exposures with **similar characteristics**, such that the risks associated with such exposure are substantially reduced c) the institution treats the exposure in its risk management framework and manages the exposure internally as retail exposure **consistently over time** and in a manner that is similar to the treatment by the institution of other retail exposures

Credit risk - Standardised approach (SA) (7/11)

4

- Alignment of the **classification of retails exposures** under **SA-CR with the classification under the IRB approaches**, in order to ensure a consistent application of the correspondent risk weights to the same set of exposures
- The **CRR III proposal modifies** the **criteria for the identification of retail exposures**

Retail exposures (Art. 123)

AS IS

- Exposures to **retail** shall be assigned a risk weight of **75%**

TO BE

- Exposures to **retail** shall be assigned a risk weight according to the following table

Retail exposures - Risk weights

Type of exposure	Risk Weight
Exposures to natural person(s) that cannot be classified as retail exposures	100%
Retail exposures	75%
Transactor exposures	45%
Exposures due to loans granted to pensioners or employees	35%[a]

[a] In order to apply the risk weight of 35% to exposures due to loans granted by an institution to pensioners or employees with a permanent contract against the unconditional transfer of part of the borrower's pension or salary to that institution, all the following conditions must be met:

- *a) to repay the loan, the borrower unconditionally authorises the pension fund or employer to make direct payments to the institution by deducting the monthly payments on the loan from the borrower's monthly pension or salary*
- *b) the risks of death, inability to work, unemployment or reduction of the net monthly pension or salary of the borrower are properly covered through an insurance policy to the benefit of the institution*
- *c) the monthly payments to be made by the borrower on all loans that meet the conditions set out in points (a) and (b) do not in aggregate exceed 20 % of the borrower's net monthly pension or salary*
- *d) the maximum original maturity of the loan is equal to or less than ten years*

Note: (a) Such RW could be applied only where specific conditions are met. For more detail, please see Annex

Credit risk - Standardised approach (SA) (8/11)

5

- Introduction of specific criteria[a] to classify a **non-ADC exposure** as secured by **residential / commercial immovable property** and as **IPRE/non-IPRE**[b]. If such criteria are not met (i) Non-IPRE exposures shall be treated as not secured by the immovable property and (ii) IPRE exposures shall be risk-weighted at 150%
- Introduction of **different risk weights** for (i) non-IPRE exposures (applicable on a part of exposure) and (ii) IPRE exposure (based on "exposure-to-value" (i.e. ETV) ratio buckets)

Exposures secured by immovable property (art. 124 – 126a)

AS IS

Exposures secured by immovable property

Type of exposure	Risk weights to be applied
Exposure secured by residential property	a) the part of exposure up to 80% of the property value (net of any senior or *pari passu* ranking external liens) shall be assigned a risk weight of 35% b) the remaining part of the exposure shall be treated as not secured
Exposure secured by commercial property	a) the part of the exposure up to 50% of the property value (net of any senior or *pari passu* ranking external liens) shall be assigned a risk weight of 50% b) the remaining part of the exposure shall be treated as not secured

TO BE

Non-ADC exposures secured by immovable property - Risk weights: IPRE exposures

Type of exposure	ETV ≤ 50%	50%<ETV≤60%	60%<ETV≤80%	80%<ETV≤90%	90%<ETV≤100%	ETV > 100%
A Exposure secured by residential property	30%	35%	45%	60%	75%	105%
B Exposure secured by commercial property	70%		90%	110%		

Non-ADC exposures secured by immovable property - Risk weights: Non-IPRE exposures

Type of exposure	Risk weights to be applied
C Exposure secured by residential property	a) the part of exposure up to 55% of the property value (net of any senior or *pari passu* ranking external liens) shall be assigned a risk weight of 20% b) the remaining part of the exposure shall be treated as not secured
D Exposure secured by commercial property	a) the part of the exposure up to 55 % of the property value (net of any senior or *pari passu* ranking external liens) shall be assigned a risk weight of 60% b) the remaining part of the exposure shall be treated as not secured

Note: (a) For more details on criteria to classify a non-ADC exposure, please see Annex
(b) IPRE stands for Income Producing Real Estate

Credit risk - Standardised approach (SA) (9/11)

5

- Introduction of specific risk weights for **land acquisition, development and construction** (i.e. ADC) **exposures**

Land acquisition, development and construction exposures (Art.126a)

AS IS

- **N/A**

TO BE

- Exposures to **land acquisition, development and construction exposures** shall be assigned a risk weight according to the following table

Land acquisition, development and construction exposures	
Type of exposure	Risk Weight
ADC exposures	150%
ADC exposures to residential property	100%

Where applicable, only if the institution applies sound origination and monitoring standards which meet the **requirements** in terms of Internal Governance and Recovery and Resolutions plans and Credit and Counterparty Risk [(a)] and where at **least one** of the **following conditions** is met:

a) **legally binding pre-sale or pre-lease contracts**, for which the purchaser or tenant has made a substantial cash deposit which is subject to forfeiture if the contract is terminated, amount to a significant portion of total contracts

b) the obligor has **substantial equity at risk**, which is represented as an appropriate amount of obligor-contributed equity to the residential property's appraised value upon completion

Note: (a) Articles 74 and 79 of Directive 2013/36/EU

Credit risk - Standardised approach (SA) (10/11)

6

- Clarification of the **equity exposure scope**[(a)] and application of more granular risk weights

Equity and subordinated debt exposures (Art. 128 & 133)

AS IS

- The following exposures shall be considered **equity exposures**:

a) **non-debt exposures** conveying a subordinated, residual claim on the assets or income of the issuer;

b) **debt exposures** and other securities, partnerships, derivatives, or other vehicles, the **economic substance** of which is similar to the exposures specified in point (a).

- Exposures to **equity** shall be assigned a risk weight according to the following table

	Equity exposures	High risk equity exposures	Significant investment in a financial sector entity (not deducted from own funds and not treated as high risk item)	Qualifying holdings outside the financial sector
RWs	100%	150%	250%	1250%

TO BE

- Subordinated debt exposures shall be assigned a **risk weight of 150 %**
- Exposures to **equity** shall be assigned a risk weight according to the following table

	Equity exposures to certain official programs *(Requires the CA's permission)*	Unlisted speculative equity	Other equity exposures	Equity exposures to central banks	Equity exposures that are recorded as a loan but arise from a debt/equity swap made as part of the orderly realisation or restructuring of the debt
RWs	100%	400%	250%	100%	The risk weight must <u>not</u> be lower than the risk weight that would apply had the equity holdings remained in the debt portfolio

Note: (a) For more details, please see Annex

Credit risk - Standardised approach (SA) (11/11)

7

- Clarification concerning the **risk weight treatment of discounts** on **purchases of non-performing exposures**, complementing the EBA's ongoing work aimed at amending the RTS on credit risk adjustments

	AS IS	TO BE
Defaulted exposures (Art. 127)	▪ **N/A**	▪ For the purposes of calculating the **sum** of **specific credit risk adjustments**, institutions shall include any positive difference between the **amount owed by the obligor** on the exposure and the sum of: i. the **additional own funds** reduction if the exposure was written off fully; and ii. any **already existing own funds reductions** related to that exposure
	▪ The **exposure value** remaining after **specific credit risk adjustments** of exposures fully and completely secured by mortgages on residential property shall be assigned a risk weight of **100 %** if a default has occurred	▪ The **exposure value** remaining after specific credit risk adjustments of **non-IPRE exposures secured by residential or commercial immovable property** shall be assigned a **risk weight of 100 %** if a default has occurred

Credit risk- internal rating based approach (1/8)

- The **AIRB Segmentation** has seen three main changes:
  - Insertion and removal of **exposure classes**
  - Further distinction of **Corporate** and **Retail exposures**
  - **New regulatory technical standards** to be published between 18 months after the entry into force of the amending and the 31st Dec 2025

Segmentation (Art. 142,143,144,147)

AS IS	TO BE
7 **Exposure Classes**	10 **Exposure classes**. Then new ones are: – Exposures to **regional and local authorities** ('RGLAs') – Exposures to **public sector entities** ('PSEs') – Exposures in the form of **units or shares in a CIU**[1]
Corporates are a unique exposure class	**Corporates** is split into General corporates, Specialised lending ('SL', further distinguished among three subclasses) and Corporate purchased receivables. **Large corporate** is defined as any corporate having consolidated annual sales of more than 500€ MLN
Retail is a unique exposure class	**Retail** is further split into Qualifying revolving retail exposures ('QRREs'), Retail exposures secured by residential property, Retail purchased receivables, Other retail exposures
For the 1€ MLN threshold in the definition of Retail, only Past Due exposures are considered	For the 1€ MLN threshold in the definition of **Retail**, any defaulted exposure must be considered
	New regulatory technical standards for the segmentation by 31st Dec 2025

1. Collective Investment Undertakings

Credit risk- internal rating based approach (2/8)

- The **LGD parameter** is affected by the changes introduced by the new regulation with reference to three main aspects:
  - New asset classes have a **value of LGD** that is **set by the regulator**
  - **New floors** in the value of LGD have been introduced
  - Some changes in the **estimation process**

LGD (Art. 151, 159a, 161, 164, 181)

AS IS

- **LGD** is **given** for the following classes:

Asset Class	LGD
senior exposures without eligible collateral	45%
subordinated exposures without eligible collateral	75%
covered bonds	11,25%
senior purchased corporate receivables exposures where an institution is not able to estimate PDs	6,45%
subordinated purchased corporate receivables where an institution is not able to estimate PDs	100%

TO BE

- **LGD** is **given** for the following classes:

Asset Class	LGD
senior exposures without FCP[1] to central governments and central banks and financial sector entities	45%
senior exposures without FCP, to corporates which are not financial sector entities	40%
subordinated exposures without eligible collateral	75%
for senior purchased corporate receivables exposures where an institution is not able to estimate PDs	40%
subordinated purchased corporate receivables where an institution is not able to estimate PDs	100%

- For **Corporates**, the **LGD** shall **not** be **less than**:

without FCP (LGDU[2]-floor)	Fully secured by FCP (LGDS[3]-floor)	
25%	financial collateral	0%
	receivables	10%
	residential or commercial immovable property	10%
	Other physical collateral	15%

- Exposures to **Large Corporates, Institutions and Financial Sector Entities** must use **SA-CR LGD**

1. FCP: funded credit protection
2. LGDU: LGD unsecured
3. LGDS: LGD secured

Credit risk- internal rating based approach (3/8)

LGD
(Art. 151,159a, 161, 164, 181)

AS IS

- A **floor** was identified for **some Retail** exposures:

Asset Class	LGD
exposures secured by residential property	10%
secured by commercial immovable property	15%

- In the context of LGD estimation, master **netting agreements and on-balance sheet netting of loans and deposits** shall be **considered**
- N/A

TO BE

- For **Retail**, the LGD shall **not** be **less than**:

Asset Class		without FCP (LGDU-floor)	fully secured by FCP (LGDS-floor)
exposure secured by residential property		N/A	5%
QRRE		50%	N/A
Other retail	secured with financial collateral	30%	0%
	secured with receivables		10%
	residential/commercial immovable property		10%
	Other physical collateral		15%

- The applicable LGD input floor (LGD floor) for an exposure partially secured with FCP is calculated as it follows:

$$LGD_{floor} = LGD_{U-floor} * \mathrm{EU} * \mathrm{E}(1 + H_E) + LGD_{S-floor} * \mathrm{ES} * \mathrm{E}(1 + H_E)$$

- **Floors do not apply** to the part of exposures covered by an **eligible guarantee provided by a Member State's central government or central bank** or by the **ECB**
- In the context of LGD estimation, **master netting agreements and on-balance sheet netting of loans** and deposits shall **NOT be considere**d
- Additional drawings after default shall accounted for in the LGD

Credit risk- internal rating based approach (4/8)

- The **PD parameter** is affected by the changes introduced by the new regulation with reference to two main aspects:
  - **New minimum value** of the PD
  - Some changes in the **estimation process**
- Default has remained similar to the previous definition

	AS IS	TO BE
PD (Art. 159a, 163, 180)	▪ The **minimum PD** is set at **0,03%** ▪ Unfunded credit protection may be taken into account by adjusting PDs	▪ The **minimum PD** is set at **0,05%** except for QRRE where the limit is 0,1% ▪ For an exposure covered by an unfunded credit protection, institutions using own LGD estimates for direct comparable exposures to the protection provider may recognize the unfunded credit protection ▪ For exposures to corporates, institutions and central governments and central banks, the PD for each rating grade based on the observed historical average one-year default rate **must be** a simple average based on number of obligors (no weighted average)
Default (Art. 178)	▪ Default shall be considered if the obligor is **past due** more than **90 days**. This time could be increased up to **180 days for exposures secured by residential or SME commercial real estate**	▪ Default shall be considered if the obligor is **past due** more than **90 days** ▪ A distressed restructuring shall be considered to have occurred when forbearance measures have been extended toward the obligor

Credit risk- internal rating based approach (5/8)

- The **CCF parameter** is affected by the changes introduced by the new regulation with reference to two main aspects:
  - **Off Balance items** for which IRB approach can be used **are reduced**
  - CCF are not based anymore on the perceived risk but **Standard CCF must be used**

CCF
(Art. 166, 182)

AS IS

Item	CCF
credit lines that are unconditionally cancellable at any time by the institution	0%
short-term letters of credit arising from the movement of goods	20%
undrawn purchase commitments for revolving purchased receivables that are able to be unconditionally cancelled	0%
for other credit lines, note issuance facilities (NIFs), and revolving underwriting facilities	75%
Full Risk	100%
Medium Risk	50%
Medium / Low Risk	25%
Low Risk	0%

- Institutions' estimates of **conversion factors** shall reflect the **possibility of additional drawings** by the obligor **up to and after** the time a default event is triggered.

TO BE

- If IRB CCF is not used, the institution should apply the **SA CCF to the lower of the value of the unused committed credit line**, and the value that reflects any possible constraining of the availability of the facility
- If permitted, institutions should use **IRB-CCF for exposures arising from undrawn revolving commitments**, except those exposure are subject to a 100% SA CCF. In case, the exposure value shall not be less that then the sum of the CCF input floor[1]
- **SA CCF** must be use for all other off-balance sheet items

- IRB-CCF shall reflect the **possibility of additional drawings** by the obligor up to the time a default event is triggered
- Drawings after default are included in the LGD estimates

1. Drawn amount of the revolving commitment + 50 % of the off-balance exposure amount of the remaining undrawn part of the revolving commitment calculated using the SA-CCF

Credit risk- internal rating based approach (6/8)

- The **RWA calculation** is affected by the changes introduced by the new regulation with reference to two main aspects:
  - Small changes in the **formula**
  - The regulation for the **Maturity** computation has changed

	AS IS	TO BE
Maturity (Art. 162)	▪ If an institution does not apply its own estimates of LGD, then for exposures to corporates, institutions or central governments and central banks the maturity is 0.5 years, else is 2.5 year	▪ If an **institution does not apply its own estimates of LGD**, then, except for exposures arising from securities financing transactions where m is 0.5, **maturity** must be set at **2.5 years** ▪ For **revolving exposures**, M shall be determined using the maximum contractual termination date of the facility. Institutions shall not use the repayment date of the current drawing if this date is not the maximum termination date of the facility
Risk Weight (Art. 153, 154)	▪ The **RW formula** includes a **6% increase** of the value ▪ For all exposures to **large financial sector**, **R** must be **multiplied by 1.25** ▪ For **retail** exposures **secured by immovable property collateral** a coefficient of correlation **R** of **0.15** must be used	▪ The **RW formula** does **not** include a **6% increase** of the value ▪ For exposures to **large regulated financial sector entities** and to **unregulated financial sector** entities **R** shall be **multiplied by 1.25** ▪ For **retail** exposures that are not in default and are secured or partly **secured by residential property**, a coefficient of correlation **R of 0.15** must be used for both the **secured and unsecured part**

Credit risk- internal rating based approach (7/8)

- **Rating systems** must consider more **drivers** with reference to the migration from one grade to another

Rating Systems
(Art. 170,171,173,174,177)

AS IS	TO BE
Institutions shall consider **transaction risk characteristics**, including **product or collateral types** or both, when assigning exposures to grades or pools	Institutions shall consider **transaction risk characteristics**, including **product and funded credit protection**, recognized unfunded credit protection, loan to value measures, seasoning and seniority, when assigning exposures to grades or pools.
	For each pool where the institution estimates PD and LGD, the institution shall analyze the **representativeness of the age of the facilities** in terms of time since origination for PD and time since the date of default for LGD
	Rating systems shall be designed in such a way that **idiosyncratic or industry-specific changes are a driver of migrations from one grade to another**. In addition, business cycles effects shall be taken into account as a driver for migrations of obligors and facilities
Institutions shall consider as part of their **stress testing framework** the impact of a **deterioration in the credit quality of protection providers**	Institutions are **not** required to consider the **impact of a deterioration in the credit quality of protection providers in their stress testing framework**

Credit risk- internal rating based approach (8/8)

- **Internal Models for Equity exposures** are to be **dismissed**. The new Regulation provides arrangements for the transition

Equity
(Art. 143,144,147, 494d, 495a, 495b)

AS IS	TO BE
Material changes must be **notified** to competent authorities	**Material changes** must **NOT** be **notified** to competent authorities
Internal Model for Equity exposures could be **authorized**	**New internal models** approaches for **equity exposures are not allowed**
	Between 1st Jan 2025 and 31st **Dec 2027 institutions may revert the STA approach** if the IRB was applied when the regulation came into force. Institutions may request a reversal only once
	Until 31st **December 2029**, institutions must **calculate the RWA** as the **highest between the risk weighted exposure amount calculated in accordance with the transitional arrangements and the risk weighted exposure amount calculated under this Regulation as it stood**. Alternatively, institutions can apply the transitional arrangements (art 495a, 495b)

Credit risk- credit risk mitigation

- Articles 192 to 230 were amended to implement the Basel III rules and methods taking into account some collateral and guarantees under both the SA-CR and the F-IRB approach.
- Under the financial collateral comprehensive method, the supervisory haircuts applicable to financial collateral (funded and unfunded), and the values of secured LGDs and collateral haircuts applicable to exposures treated under the F-IRB were reviewed and updated.
- Article 213(1), point (c)(iii), and Article 215(2) were amended to clarify the eligibility criteria for guarantees and, respectively; guarantees provided in the context of mutual guarantee schemes or provided by counter-guaranteed by some entities.

Credit Risk Mitigation (CRM)
Art. 192 to 230

AS IS

- **Eligible forms FCP:** Losses stemming from loans collateralized by residential **property up to 80 %** of the market value or 80 % of the mortgage-lending-value.
- **Calculation effects of CRM**: Refers to Using the Supervisory Volatility Approach or the Own Volatility Approach for master netting agreement:

$$E^* = max\left\{0, \left(\sum_i E_i - \sum_i C_i\right) + \sum_j |E_j^{sec}| * H_j^{sec} + \sum_k |E_k^{fx}| * H_k^{fx}\right\}$$

- **Calculation effects of CRM:** Calculation RWA and expected amounts under IRB approach. The LGD formula is defined in the art. 228 and a table with the minimum LGD for secured parts is defined

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

TO BE

- **Eligible forms FCP:** Losses stemming from loans collateralized by residential **property up to 55 %** of the value determined in accordance with Article 229.
- **Calculation effects of CRM**: Reference to "Own Estimates Volatility Adjustments " have been removed and formula to calculate E* has been changed:

$$E^* = max\left(0; \sum_i E_i - \sum_j C_j + 0{,}4 * E_{net} + 0{,}6 * \frac{E_{gross}}{\sqrt{N}} + \sum_k |E_k^{fx}| * H_k^{fx}\right)$$

- **Calculation effects of CRM: FCP**: In the Art. 230/231 the formula for calculating LGD has changed, the table for minimum LGD for secured parts has been deleted and new specific values of LGDs and Haircuts applicable in the formula have been defined.

$$LGD^* = LGD_U \frac{E_U}{E(1+H_E)} + LGD_S \frac{E_S}{E(1+H_E)}$$

Agenda

Market Risk - Overview

In line with Basel 4's revised FRTB standards, binding own funds requirements for market risk are introduced. FRTB approaches - alternative standardised approach (A-SA), alternative internal model approach (A-IMA) and simplified standardised approach (SSA) - are defined along with their conditions for use, and the frequency of calculation of the own funds requirements. Most notably, existing internal model approaches to calculate own fund requirements are replaced with the FRTB A-IMA.

STANDARD APPROACH

GENERAL

- ***Simplified SA*** definition and new risk class-specific multiplication factors are introduced. (Art.325-325a);
- New criteria for calculating own fund requirements in case of **undertakings** for which the competent authority has not granted permission of consolidation are defined(Art.325b);
- **New qualitative requirements** related to *Alternative SA* are defined (Art.325c/t).

METRICS

- Delegated Act confirmation and integration about the **treatment of CIUs**: the application of look-through methodology and the alternative "single equity position" treatment (specified in Art.325j);
- FX Vega risk factors shall be the implied volatilities of exchange rates between **currency pairs** (Art.325q);
- Vega risk sensitivity formula involves directly implied volatility (Art.325s);
- Traded non-SEC credit and equity derivatives are subject to **look-through approach** (Art.325v);
- RW for inflation and cross-ccy basis risk factors are divided by √2 (Art.325ae);
- CSR (SEC and non-SEC) bucketing table is modified by introducing **covered bonds** in bucket 13(Art.325ah/ak);
- **Commodity bucketing** table is modified by splitting bucket 3 in two different subcategories (*Energy – Electricity* and *Energy – Carbon Trading*) (Art.325as);
- **Correlation parameters** ρkl (name) and γbc (rating) are modified, specifically for index positions (Art.325ai/aj);
- **Credit quality category** is now assigned as the one considered under the *Standard Approach* for Credit Risk (Art.325am/y).

INTERNAL MODEL APPROACH

- EBA shall develop a **RTS to specify the concept of "sufficiently close" in the comparison among RTPL and HPL** values performed under PLAT requirements. (Art.325bg);
- New **derogations by Competent Authorities on the modellability** of risk factors are introduced (Art.325be);
- EBA will develop RTS to specify the criteria for the use of **data inputs in the risk-measurement** model (Art.325bc).

- Under specific circumstances, the **possibility of excluding over-shootings under the back-testing of HPL or APL** is introduced. Moreover, Competent Authorities have the power of increasing multiplication factor if an institution's internal model shows deficiencies to measure appropriately the own funds requirements. EBA will develop RTS specifying the criteria related to a back-testing breach which is attributable to a **NMRF**. (Art.325bf);
- Under the *Alternative Internal Model Approach*, a **new formula for the calculation of total own funds requirements for all trading book positions and all non-trading book positions generating foreign exchange or commodity risks** is defined. (Art.325ba);
- New criteria used to **assign positions to the TB or to BB introduced** (Art 104) and new requirements for reclassification of a position (104a);
- For what regards the treatment of CIUs, the **application of look-through methodology is defined and set on a weekly basis**. (Art.325bh).

REMARKS:
- Pillar I Requirements live from January 2025
- No change about Curvature Risk Weights Art.325ax(6)

Market risk

In line with Basel 4's revised FRTB standards, binding own funds requirements for market risk are introduced. FRTB approaches - alternative standardised approach (A-SA), alternative internal model approach (A-IMA) and simplified standardised approach (SSA) - are defined along with their conditions for use, and the frequency of calculation of the own funds requirements. Most notably, existing internal model approaches to calculate own fund requirements are replaced with the FRTB A-IMA.

	STANDARD APPROACH	INTERNAL MODEL APPROACH
GENERAL	▪ ***Simplified SA*** definition and new risk class-specific multiplication factors are introduced. (Art.325-325a); ▪ New criteria for calculating own fund requirements in case of **undertakings** for which the competent authority has not granted permission of consolidation are defined(Art.325b); ▪ **New qualitative requirements** related to *Alternative SA* are defined (Art.325c).	▪ EBA shall develop a **RTS to specify the concept of "sufficiently close" in the comparison among RTPL and HPL** values performed under PLAT requirements. (Art.325bg). ▪ New **derogations by Competent Authorities on the modellability** of risk factors are introduced (Art.325be).
METRICS	▪ Delegated Act confirmation about the **treatment of CIUs**: the application of look-through methodology and the alternative "single equity position" treatment (specified in Art.325j); ▪ CSR (SEC and non-SEC) bucketing table is modified by introducing **covered bonds** in bucket 13(Art.325ah/ak); ▪ **Vega risk weights** are modified by introducing a table with risk class-specific weights(Art.325ax); ▪ **Correlation parameters** ρkl (name) and γbc (rating) are modified, specifically for index positions (Art.325ai/aj); ▪ **Commodity bucketing** table is modified by splitting bucket 3 in two different subcategories (*Energy – Electricity* and *Energy – Carbon Trading*) (Art.325as); ▪ **Credit quality category** is now assigned as the one considered under the *Standard Approach* for Credit Risk (Art.325am/y).	▪ For what regards the treatment of CIUs, the **application of look-through methodology is defined and set on a weekly basis**. (Art.325bh); ▪ Under specific circumstances, the **possibility of excluding over-shootings under the back-testing of HPL or APL** is introduced. Moreover, Competent Authorities have the power of increasing multiplication factor if an institution's internal model shows deficiencies to measure appropriately the own funds requirements. (Art.325bf); ▪ Under the *Alternative Internal Model Approach*, a **new formula for the calculation of total own funds requirements for all trading book positions and all non-trading book positions generating foreign exchange or commodity risks** is defined. (Art.325ba).

REMARKS:
- Pillar I Requirements live from January 2025
- No change about Curvature Risk Weights Art.325ax(6)

Credit Valuation Adjustment risk framework

The **credit valuation adjustment** (CVA) is a fair-value accounting adjustment to the price of a derivative transaction, aiming to provision against potential losses due to the deterioration in the creditworthiness of the counterparty to that transaction.

- After the financial crisis, the **BCBS introduced in 2011 new standards to calculate capital requirements for CVA risk**, as part of the first set of Basel III reforms, to ensure that banks' CVA risk would be covered with sufficient capital in the future. **Transposed to EU law in 2013**.
- Banks and supervisors expressed **concern that the 2011 standards did not adequately reflect the actual CVA risk** banks were exposed to. These concerns focused on:
    1. *The approaches presented lack of risk-sensitivity*
    2. *CVA models developed by bank for accounting purposes were not recognized*
    3. *The approaches set out did not capture the market risk embedded in the derivative transactions with counterparty*
- For this reason, in order to address those concerns, the **BCBS published revised standards in December 2017** and further adjusted their calibration in July 2020, as part of the final Basel III reforms. As a consequence, **CRR3 proposal incorporates significant changes in the CVA calculation methodology approaches** with respect to CRR2.

HOW DOES CRR3 UPDATE AFFECT PREVIOUS CVA CAPITAL REGULATION?

1. MEANING

Art. 381 CRR

Definition of the meaning of CVA risk introduced to capture the credit spread risk of an entity's counterparty and the market risk of the portfolio of transactions traded by that entity with that counterparty.

2. SCOPE [1]

Art. 382 CRR

Reporting requirement of results on transactions exempt from the CVA risk calculation, taking to account the corresponding eligible hedges. Additionally, **fair-valued SFTs are included** within the scope of CVA.

3. APPROACHES [2]

Art. 383 – 385 CRR

Explanation of the different approaches for CVA risk calculation clarifying the specifications of each one.

- ~~Advanced Method~~ **Standardised Approach (SA-CVA)**
- ~~Standardised Method~~ **Basic Approach (BA-CVA)**
- ~~Alternative Method~~ **Simplified Approach**

4. HEDGES

Art. 386 CRR

Implementation of new requirements applicable to eligible hedges for the purposes of the own fund requirements for CVA risk.

1. Development of ECB guidelines required to identify excessive CVA risk and specify conditions for assessing the materiality of CVA risk exposures from fair-valued SFTs
2. Requirements set out in the regulation have been largely transferred from those developed by the BCBS CVA Framework Paper

Agenda

Operational risk

- All existing approaches for the calculation of the own funds requirements for operational risk are replaced by a single non-model-based approach to be used by all institutions.
- The forthcoming approach is based on an indicator of the institution's business size (Business Indicator), weighted by a coefficient ranging from 12% to 18% - according to institution's size – to compute the Business Indicator component (BIC). Leveraging jurisdictional discretion, CRR3 proposal dismisses the use of historical loss for regulatory capital computation
- However data collection and governance rules are now introduced
- No phase-in is foreseen. Institutions will compute Pillar 1 capital requirement solely as the BIC from 2025

STANDARD APPROACH

GENERAL

- A one-size-fit-all Standardized Approach (SA) is introduced for all institutions. No internal model allowed for pillar I, but institutions can still use/develop them for pillar II.
- Institutions with a BI ≥ EUR 750 mln are required to disclose losses and shall then establish on ongoing basis a loss data set, by recording each operational risk event. Loss data collection (LDC) scope is closely aligned to current AMA criteria and institutions currently adopting TSA or BIA may need to fine tune its LDC process.
- CRR 3 sets out several soundness and resilience requirements over the development and management of the IT infrastructure supporting LDC and focuses on the quality of operational loss data (i.e. regulatory review every three years for an institution with a business indicator above EUR 1 bln and independent review carried out by the institution, internally or by external auditor).
- CRR 3 proposal extends to all institutions current TSA and qualitative AMA requirements to all institutions, , as a consequence, not only LDC, but also other traditional ORM framework components such as risk assessment, scenario analysis, KRI and even measurement could be instrumental under the new Standardised Approach

METRICS

- Capital will be proportional to business volume (sum of interest, service and financial income components). No role for historical data in determining capital requirement as CRR3 opts for the jurisdictional discretion to set internal loss multiplier (ILM) at 1 for all insitutions.
- The definition of BIC (as compared to gross income currently used for calculating the more simple Pillar 1 approaches) entails the removal of netting rules for financial profit vs. loss and commission income vs. commission expenses. This could drives higher capital requirements for some business activities (e.g. commission based business).

Agenda

ESG risk

- CRR introduces a harmonised definition of ESG risks which is proposed to apply as of 1 January 2025 and new reporting requirements.
- CRD6 (business strategy, ICLAAP, ESG risk management, stress testing and supervision) is proposed to apply 18 months after transposition in national law.
- All EBA Guidelines are due by 28 June 2023.

Summary of main intervention

ESG requirements

RISK MANAGEMENT:

- Through CRD banks will be required to identify, measure, manage and monitor ESG risks. EBA will develop specific guidelines. EBA is furthermore enabled to develop specific guidelines on climate related stress testing, update standards on supervisory reporting to include exposures to ESG risks, extend Pillar 3 disclosures to be applicable to a significantly larger set of banks. EBA will deliver its report on classification and prudential treatment of assets from a sustainability perspective by 28 June 2023.
- Article 4 CRR is amended to introduce new harmonised definitions of the different types of risks in the universe of ESG risks (Article 4(1), points 52d to 52i). The definitions are aligned with those proposed by EBA in its report dedicated to ESG risks. Environmental risks are defined to include factors explicitly related towards the six objectives given in the EU Taxonomy
- To allow for better supervision of ESG risks, Article 430 is amended to require institutions to report their exposure to ESG risks to their competent authorities.
- ICLAAPs to consider ESG risks on short, medium and long-term horizons (>10 years).

BUSINESS STRATEGY:

- CRD requires at least a 10 years horizon in business strategy, planning and scenario analyses.
- Quantifiable targets to monitor and address ESG risks must be developed.
- Incentives for banks strategies to align with objectives stemming from among others the EU Green Deal and EU Sustainable Finance Strategy.

Agenda

Disclosure requirements, Delegated and Implementing acts and Empowerments to EBA (1/3)

- The Commission introduced modification and novelties on a wide range of topic covered in the final sections of CRR, focusing mainly on: Disclosure requirements, Delegated and Implementing acts and allocating mandates to EBA (so called *EBA empowerments*)
- Regarding **Disclosure requirements**, main intervention are summarised below

Summary of main intervention

Disclosure requirements

- The **disclosure related to ESG risks** has been introduced within the general disclosure requirements (see section 6 of this document for further details)
- The **percentages** considered for the purposes of reporting to Competent Authorities **losses from immovable** (residential and commercial) **property** are modified (these percentages are relevant for the so called *hard test* in the SA for credit risk)
- The **disclosure of capital requirements** and key metrics is amended to take into account the introduction of **output floor**
- Requirements on **scope, frequency and means of disclosure to EBA are slightly modified** to take into account other changes (such as reporting of output floor), while the **EBA is mandated to develop a new ITS** on disclosure formats
- **Risk-specific reporting requirements are introduced or amended**, in particular:
  - **Market risk**: new disclosure requirements for Institutions that will use the Simplified Standardised Approach are provided, while the disclosure requirements in case of internal model use are amended accordingly to the new framework
  - **CVA risk**: Institutions subject to own fund requirement for CVA risk will be required to disclose a certain set of information (such as process to identify, measure and monitor CVA risk, the regulatory approach used)
  - **Operational risk**: the information to be disclosed are amended accordingly to the overall revised framework for the computation of capital requirements,

Disclosure requirements, Delegated and Implementing acts and Empowerments to EBA (2/3)

- The Commission introduced modification and novelties on a wide range of topic covered in the final sections of CRR, focusing mainly on: Disclosure requirements, Delegated and Implementing acts and allocating mandates to EBA (so called *EBA empowerments*)
- Regarding **Delegated and Implementing acts**, main intervention are summarised below

Summary of main intervention

Delegated and Implementing acts

- The **notification procedure to ESRB and other Authorities** (EU Council, EU Commission, EBA and other Member States), related to macroprudential or systemic risk identified at the level of a Member State, has been **slightly modified**
- **European Commission** will be in charge for **monitoring the implementation of the new international standards for market risk across third countries**, and in case significant differences are detected, the Commission is empowered to amend the market risk framework to level the playing field
- **European Commission** is mandated to **review whether a dedicated prudential treatment for crypto assets should be developed** (after consulting with EBA and taking into account international developments) and, in that case, the Commission should submit a legislative proposal
- The **exercise of delegation power allocated to the Commission has been slightly modified**, to cover also for the potential introduction of a prudential treatment for crypto assets

Disclosure requirements, Delegated and Implementing acts and Empowerments to EBA (3/3)

- The Commission introduced modification and novelties on a wide range of topic covered in the final sections of CRR, focusing mainly on: Disclosure requirements, Delegated and Implementing acts and allocating mandates to EBA (so called *EBA empowerments*)
- Regarding **EBA empowerments**, main intervention are summarised below

Summary of main intervention

EBA empowerments

- The proposal contains **various mandates to the EBA**, in particular:

a) to report to the Commission by **31 December 2030** on the **impact of the CRR provisions on agricultural finance**

b) to report to the Commission by **31 December 2026** on the **eligibility and use of policy insurance as credit risk mitigation techniques** (for both Standardised and IRB approach)

c) to assess and report to the Commission by **31 December 2026** on the **interaction between CET1 reductions and credit risk parameters**

d) to report to the Commission (**by 12 months after the entry into force of the Regulation**) on the possible **implementation in EU of the minimum haircut floors framework applicable for SFTs** (Securities Financing Transactions)

e) to report to the Commission (**by 60 months after the entry into force of the Regulation**) on the **use of insurance in the context of the revised operational risk framework**

Leverage Ratio

- The European Commission proposes some modification to the Leverage Ratio framework, in order to align with the overall revised Regulation
- In particular, changes are introduced in the definition of regular-way purchase or sale, treatment of client-cleared derivatives and calculation of exposure value of off-balance sheet items

Leverage ratio

AS IS	TO BE
• When defining ***regular-way purchase or sale*** CRR refers only to security • **Calculation of exposure value** for the purpose of Leverage Ratio is **aligned with the current CCR framework** • For the purpose of **computing the calculation of exposure value of off-balance sheet low-risk items**, there is a derogation from the conversion factor used by the Standardised Approach (SA) for Credit Risk, **setting a 10% conversion factor instead of 0%**	• References to ***regular-way purchase or sale*** are extended to financial assets instead of securities • Rules on the **calculation of exposure value of derivatives** are amended, to **align with the treatment of client-cleared derivatives under SA-CCR**. In particular: – Additional specifications on the conditions to the recognise collaterals in forms of cash (paragraph 3 point a) – Exclusion of collateral received in the calculation of NICA with no exceptions (paragraph 4), – List of conditions under which is possible to recognise collateral received (new paragraph 4a) • For the **calculation of exposure value of off-balance sheet fully alignment with SA for Credit Risk conversion factor**, which prescribes a 10% conversion factor for low risk items

Annex

Credit risk - Standardised approach (SA) (1/6)

The main changes with respect to the Credit Risk standardised approach are:

3 Corporate exposures – Specialised lending exposure categories (1/2) (art.122a)

— For the purposes of assigning a RW to **specialised lending exposures** with a not-available ECAI's **credit assessment, an institution shall** follow specific qualitative criteria to identify the correct type of exposure

Object Finance

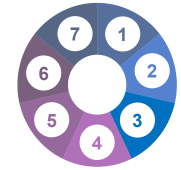
- ❑ the **purpose** of the specialised lending exposure is to **finance** the **acquisition** of **physical assets**
- ❑ the **income** to be generated by those assets comes in the **form** of **cash flows generated** by the **specific physical assets** that have been finance and pledged or assigned to the lender by one or several third parties
- ❑ the **exposure** is deemed to be **high quality** when:
  - the obligor can meet its financial obligations even under severely stressed conditions [(a)]
  - the contractual arrangements on the assets provide lenders with a high degree of protection
  - the technology and design of the asset are tested and the necessary permits and authorisations for the operation of the assets have been obtained
  - where the asset is under construction, the obligor has adequate safeguards on the agreed specifications, budget and completion date of the asset, including strong completion guarantees or the involvement of an experienced constructor and adequate contract provisions for liquidated damages
- ❑ the exposure is **not deemed to be high quality** when the abovementioned requirements are not met

Commodity Finance

- ❑ the **purpose** of the specialised lending exposure is to provide for **short-term financing** of reserves, inventories or receivables of exchange-traded commodities
- ❑ the **income** to be generated by those reserves, inventories or receivables is to be the **proceeds from** the **sale** of the **commodity**

Note: (a) due to the presence of all of the following features: (i) adequate exposure-to-value of the exposure; (ii) conservative repayment profile of the exposure; (iii) commensurate remaining lifetime of the assets upon full pay-out of the exposure or alternatively recourse to a protection provider with high creditworthiness; low refinancing risk of the exposure by the obligor or that risk is adequately mitigated by a commensurate residual asset value or recourse to a protection provider with high creditworthiness; (iv) the obligor has contractual restrictions over its activity and funding structure; (v)the obligor uses derivatives only for risk-mitigation purposes; (vi) material operating risks are properly managed;

Credit risk - Standardised approach (SA) (2/6)



The main changes with respect to the Credit Risk standardised approach are:

3

Corporate exposures – Specialised lending exposure categories (2/2) (art.122a)

— For the purposes of assigning a RW to **specialised lending exposures** with a not-available ECAI's **credit assessment, an institution shall** follow specific qualitative criteria to identify the correct type of exposure

Project Finance

- the **purpose** of the specialised lending exposure is to **finance a project** for the **development** or **acquisition** of large, complex and expensive installations
- the **income** to be generated by the project is the money generated **by the contracts** for the **output** of the **installation** obtained from one or several parties which are not under management control of the sponsor

- the **operational phase** of the financed project shall start when the entity that was specifically created to finance the project, has both a **declining long term debt** and a **positive net cash flow** that is sufficient to cover any remaining contractual obligation
- A **specific RW** can be applied to project finance exposures where the project is in the **operational phase** and the following **criteria are met**:
  - contractual restrictions on obligor's ability to perform activities that may be detrimental to lenders
  - the obligor has sufficient reserve funds fully funded in cash or financial arrangements, with highly rated guarantors
  - the obligor generates cash flows that are predictable and cover all future loan repayments [(a)]
  - the source of repayment of the obligation depends on one main counterparty (central bank, public sector entity, which has been assigned an ECAI rating with a credit quality step of at least 3)
  - the contractual provisions ensure the lending institution a high degree of protection in case of obligor's default
  - the contractual provisions effectively protect the institution against losses resulting from the project's termination
  - all assets and contracts necessary to operate the project have been pledged to the lending institution
  - equity is pledged to the lending institution such that they are able to take control of the obligor entity upon default

Note: (a) cash flows generated shall not be considered predictable unless a substantial part of the revenues satisfies one or more of the following conditions:(i) the revenues are availability-based; (ii) the revenues are subject to a rate-of return regulation; (iii) the revenues are subject to a take-or-pay contract.

Credit risk - Standardised approach (SA) (3/6)

The main changes with respect to the Credit Risk standardised approach are:

4 Retail exposures (art. 123)

— Exposures that comply with **all of the following criteria** can be classified as retail exposures:

Retail Exposure

- ❑ an exposure to **one** or **more natural persons**
- ❑ an exposure to an **SME**, where the **total amount owed** to the institution, its parent undertakings and its subsidiaries, by the obligor or group of connected clients, including any exposure in default but excluding exposures secured by residential property up to the property value **shall not**, to the knowledge of the institution, which shall take reasonable steps to confirm the situation, **exceed EUR 1 million**
- ❑ the exposure represents **one of a significant number** of exposures with **similar characteristics**, such that the risks associated with such exposure are substantially reduced
- ❑ the institution concerned treats the exposure in its risk management framework and **manages** the **exposure internally** as **retail exposure consistently over time** and in a manner that is similar to the treatment by the institution of other retail exposures

Credit risk - Standardised approach (SA) (4/6)
Focus: Criteria to classify a non-ADC exposure

Exposures secured by mortgages on immovable property

NON – ADC [(a)] Exposure

Check if the exposure secured by an immovable property fulfil all of the following conditions:

- The immovable property securing the exposure meets any of the following conditions: (i) **has been fully completed**; (ii) is **forest or agricultural land**; (iii) is **residential property under construction** or it is land upon which **a residential property** is **planned to be constructed** (where specific conditions are met)
- The exposure is secured by a **first lien held by the institution** on the immovable property
- The property value is **not materially dependent upon the credit quality of the obligor**
- All the information required at **origination** of the exposure and for **monitoring** purposes is **properly documented**
- The requirements set out in Article 208 "**Requirements for immovable property collateral**" are met and the **valuation rules** set out in Article 229 are complied with

YES [(b)]

Expo ure secured by residential property

Check if the exposure meets any of the following conditions:

- the immovable property securing the exposure is the **obligor's primary residence**
- the exposure is to an individual and is **secured by an income-producing residential housing unit**
- the exposure secured by residential property is to **associations or cooperatives of individuals**
- the exposure is secured by **residential property to public housing companies** or **not-for-profit associations**

YES

C – Non-IPRE Exposure

- Such exposure shall be treated according to **option C** (slide 16)

NO

A – IPRE Exposure

- Such exposure shall be treated according to **option A** (slide 16)

Exposure secured by commercial immovable property

D – Non-IPRE Exposure

- Such exposure shall be treated according to **option D** (slide 16)

B – IPRE Exposure

- Such exposure shall be treated according to **option B** (slide 16)

Note: (a) Loans financing land acquisition, development or construction (for more details on ADC exposures' treatment, see slide 17)
(b) If not, non-IPRE exposure treated as an exposure not secured by the immovable property; IPRE exposure with RW = 150%;

Credit risk - Standardised approach (SA) (5/6)

The main changes with respect to the Credit Risk standardised approach are:

6 Equity and subordinated debt exposures (art. 128 and 133)

— The CRR III proposal provides for **several classification criteria** for **exposures** to **subordinated debt** and **equity**

Equity exposures

- any exposure meeting **all** of the following **conditions**:
  - i. the exposure is **irredeemable** in the sense that the return of invested funds can be achieved only by the sale of the investment or sale of the rights to the investment or by the liquidation of the issuer
  - ii. the exposure does **not embody an obligation on the part of the issuer**; and
  - iii. the exposure **conveys a residual claim on the assets** or income of the issuer
- instruments that would qualify as **Tier 1 items** if issued by an institution
- instruments that embody **an obligation on the part of the issuer and meet specific conditions**[a]
- **debt obligations** and **other securities**, partnerships, derivatives or other vehicles structured in a way that **the economic substance is similar to the exposures referred to in the points above**, including liabilities from which the return is linked to that of equities
- **equity exposures** that are recorded as a **loan** but arise from a **debt/equity swap** made as part of the orderly realisation or restructuring of the debt

Equity investments not treated as equity exposures

- the equity investments are structured in a way that their economic substance is **similar to the economic substance of debt holdings** which do not meet the criteria in any of the points in the box above
- the equity investments constitute **securitisation exposures**

Subordinated debt exposures

- The following exposures shall be treated as **subordinated debt exposures**:
  - i. debt exposures which are **subordinated to claims of another creditor**
  - **ii. own funds instruments** to the extent that those instruments are **not considered** as **equity exposures**; and
  - **iii. liabilities** instruments that meet **specific conditions**[b]

Note: (a) see article 133 (1)(c)
(b) set out in Article 72b

Credit risk - Standardised approach (SA) (6/6)

The main changes with respect to the Credit Risk standardised approach are:

7

Exposure value of off-balance sheet items (art. 111)

— Institutions shall determine the **exposure value** of **off-balance sheet items** and **commitments** on off-balance sheet items according to the following requirements

Exposure Value

- The exposure value of an asset item shall be its **accounting value remaining** after **specific credit risk adjustments**, additional value adjustments in accordance related to the non-trading book business of the institution, amounts deducted and other own funds reductions related to the asset item have been applied
- **The exposure value** of an **off-balance sheet item shall be** the **following percentage** of the **item's nominal value** after the deduction of specific credit risk adjustments and amounts deducted:

Bucket	Risk weights to be applied
1	100%
2	50%
3	40%
4	20%
5	10%

- The exposure value of a **commitment on an off-balance sheet item as referred above**, shall be **the lower** of the following percentages of the commitment's nominal value after the deduction of specific credit risk adjustments and amounts deducted:

  (a) the **percentage** referred to in the **second bullet** that is **applicable to the item** on which the commitment is made

  (b) the **percentage** referred to above, that is **applicable** to the **type of commitment**

- For **contractual arrangements** offered by an institution, but **not yet accepted by the client**, that would become commitments if accepted by the client, and contractual arrangements that would qualify as commitments but meet the conditions for not being treated as commitments, the **percentage applicable** to that type of contractual arrangement shall be that provided for **in accordance with the table above**

Credit risk- credit risk mitigation (1/2)

The main changes with respect to the Credit Risk mitigation are:

1 **Definitions– (Art.192 & 193)**

— Art. 193 - Collateral that satisfies all eligibility requirements can be recognized as such even for exposures associated with undrawn facilities.

2 **Own funds– (Art. 465)**

— Art. 465 - This article establish the transitional arrangements when calculating the output floor. The institutions may allow to apply a preferential risk weight of 10% to the secured part of the exposure up to 55% of the property value, and a RW of 45% to the remaining part of the exposure up to 80% of the property value, provided certain conditions are met.

3 **Derivatives– (Art. 204)**

— Art. 204 A point has been added explaining that the risk-weights of the underlying assets included in the basket shall be aggregated up to a maximum of 1250 % and multiplied by the nominal amount of the protection.

4 **Eligible forms of CRM: UFCP- (Art. 201 y 202)**

— Art. 201 – The point (d) changes the reference of the article: Article 118 instead of Article 117.

— Art. 201 - Regulated financial sector entities have been included.

— Art. 201 – The point (g) is modified: where the credit protection is not provided to a securitization exposure, other undertakings, that have a credit assessment by an ECAI, that have a lower risk weight than that of the obligor.

— Art. 202 has been deleted.

5 **Requirements of CRM: FCP- (Art. 205 to 212)**

— Art. 208 (3) it is added: "The value shall not exceed the average value measured for that property or for a comparable over the last 3 years for commercial immovable property, and over the last 6 years for residential property". 3.a is added: "institutions may carry out the valuation of the property by means of advanced statistical or other model, developed from the credit decision process, subject to the fulfilment of conditions"

— Art. 210 - it is added "The institution may recognize those latter assets as eligible funded credit protection. In that case, that recognition shall be conditional on those assets meeting the requirements for eligibility of collateral under IRB Approach

Credit risk- credit risk mitigation (2/3)

The main changes with respect to the Credit Risk mitigation are:

6 **Requirements of CRM: UFCP- (Art. 213 to 217)**

- Art. 213 (1) - it provides that a faulty due diligence or fraud by the bank cancels or diminishes the protection, the clause shall not disqualify. in the event of fraud of the obligor, it shall. Regarding the clause, the protection may either make one lump sump of all monies, or assume the future payment obligations covered.
- Art. 215 (1) - The default of or non-payment is no longer considered by 'the counterparty', but by 'the obligor'. Additionally, it is specified the point of the requirements in Article 213 (1), adding "point (c)(iii)". Art 215 (2) The requirements of Art 213 (1)(c)(iii) are also considered. It adds (a) the condition of the obligor's default or the event of the original obligor's fail to make payments due. In (i) and (ii), it is specified that what is being talked about is the provisional payment.
- Art. 216 - New paragraph (3): For a corporate exposure covered by a credit derivative, the credit shall not need to be specified in the derivative contract provided that several conditions..
- Art. 217 - This article has been deleted.

7 **Calculation effects of CRM: FCP- (Art. 218 to 227)**

- Art. 221 - A institution may use internal models only for exposures for which the RWA are calculated under the IRB Approach.
- Art. 223 (4)(b) - For off-balance sheet items under the IRB, institutions shall calculate their exposure using CCFs 100% instead of the SA-CCFs or IRB-CCFs provided for in Art 166.8. Reference to "Own Estimated Approach" has been deleted.
- Art. 224 (1) - All these tables of Supervisory volatility adjustment have been updated.
- Art. 225 - This article has been deleted.
- Art. 226 - This paragraph has been deleted.
- Art. 227 (1) - Institutions that use the Supervisory Volatility Adjustments Approach referred to in Art. 224, may, for repurchase transactions and securities lending or borrowing transactions, apply a 0 % volatility adjustment instead of the volatility adjustments calculated under Articles 224 to 226, provided that the conditions set out in paragraph 2, points (a) to (h) are satisfied.

Credit risk- credit risk mitigation (3/3)

The main changes with respect to the Credit Risk mitigation are:

8 **Calculation effects of CRM: FCP- (Art. 228, 229, 230, 231, 232,)**

— Art. 221 - A institution may use internal models only for exposures for which the RWA are calculated under the IRB Approach.

— Art. 223 (4)(b) - For off-balance sheet items under the IRB, institutions shall calculate their exposure using CCFs 100% instead of the SA-CCFs or IRB-CCFs provided for in Art 166.8. Reference to “Own Estimated Approach” has been deleted.

— Art. 224 (1) - All these tables of Supervisory volatility adjustment have been updated.

— Art. 225 - This article has been deleted.

— Art. 226 - This paragraph has been deleted.

— Art. 227 (1) - Institutions that use the Supervisory Volatility Adjustments Approach referred to in Art. 224, may, for repurchase transactions and securities lending or borrowing transactions, apply a 0 % volatility adjustment instead of the volatility adjustments calculated under Articles 224 to 226, provided that the conditions set out in paragraph 2, points (a) to (h) are satisfied.

9 **Calculation effects of CRM: UFCP- (Art.233, 235, 236)**

— Art. 228 - the paragraph 2 has been deleted (i.e. IRB approach).

— The title of Art. 229 has been modified and the paragraph 1 has been changed including more specific requirements for the valuation of immovable property collateral, such as the value excludes expectations on price increases and the value is not higher than a market value for the immovable property when can be determined.

— The Art. 233 (4) eliminates the reference of the Article 225. In addition, the Art. 235 has been amended, the title incorporates the substitution approach, the paragraph 1 adds the unfunded credit protection nuance, and the paragraph 3 adds the references of the conditions in Article 114, paragraphs 4 or 7.

— The Art. 236 has been modified, the title incorporates the substitution approach, the paragraphs 1a to 1d have been inserted to include the treatment of estimate RWA using the PD and LGD applicable in accordance to the Article 161 (1b).

— The Article 235a/236a has been inserted to include the treatment under IRB Approach and comparable direct exposures to the protection provider under standardised approach, and the treatment using own estimates of LGD.

Market Risk - Alternative Standardised Approach (1/8)

In line with Basel 4's revised FRTB standards, binding own funds requirements for market risk are introduced. FRTB approaches - alternative standardised approach (A-SA), alternative internal model approach (A-IMA) and simplified standardised approach (SSA) - are defined along with their conditions for use, and the frequency of calculation of the own funds requirements. Most notably, existing internal model approaches to calculate own fund requirements are replaced with the FRTB A-IMA.

Scope and structure of the ASA[1]
(Art.325c P.1, 3, 4, 5 – Art. 325t)

AS IS

- There is no explicit reference to:
  - Any requirement related to a documented set of internal policies nor procedures and controls.
  - A risk control unit independent from business trading units.

TO BE

- In order to monitor and ensure compliance with the requirements of ASA, institutions shall have in place and make available to the competent authorities:
  - **A documented set of internal policies.**
  - **Procedures and controls.**
- Institutions shall have a risk control unit (independent from business trading units) reporting directly to senior management. It shall produce and analyze **monthly reports** on the output of the ASA as well as the appropriateness of the institution´s trading limits.
- Institutions shall **independently review** the ASA either as part of their regular **internal auditing process** or by mandating a **third-party** undertaking.
- The review shall cover both the activities of the business trading units and of the independent risk control unit having access to:
  - Internal policies, procedures and controls.
  - Adequacy of the documentation of the risk management system and processes and the organization of the risk control unit.
  - Accuracy of sensitivity computation referred in Art 325t.
  - Verification process that institutions employs to evaluate the consistency, timeliness and reliability of the data sources (including the independence of those data sources).
- Institutions shall conduct the review **at least one a year** or on a less frequent basis upon the approval of the competent authorities.

[1] *ASA: Alternative Standardised Approach*

Market Risk - Alternative Standardised Approach (2/8)

Treatment of CIU[1]
(Art.325j P.1, 4, 6, 7)

AS IS

- An institution shall calculate the own funds requirements using one of the following approaches, referred to **Art132(3)** and **Art132(4)(A)**:
  a) Look-through, if the institution is able to obtain sufficient information about its individual underlying exposures.
  b) In case the institution is not able to obtain sufficient information but the institution has **knowledge of the content** of the mandate of the CIU and is able to obtain **daily price quotes** for the CIU, the institution shall calculate the own funds requirements by using one of the following:
     i) Considering it as a single equity allocated to the "**Other Sector**" bucket.
     ii) Upon permission from its competent authority, it may calculate the own funds requirements in accordance with the limits set in the **mandate** and the relevant law. It may calculate also the own funds requirements for counterparty credit risk and for credit valuation adjustment risk of derivative positions using the simplified approach according to Art 132a.

     The institution shall apply the own funds requirements for the DRC and RRAO **where the mandate implies** that some exposures shall be subject to those own funds requirements.
  c) In any other case the institution shall allocate the CIU to the **non-trading book**.
- All positions in the same CIU shall use the same approach **on a stand-alone basis** as a separate portfolio.
- Referring to Point 1b) an institution shall perform the calculations under the following provisions:
- SBM and DRC, the CIU shall first take positions to the maximum extent allowed under its mandate or relevant law in the exposures attacking the **highest own funds** requirements and shall continue taking positions in descending order until the **maximum total loss** limit is reached. The CIU **shall apply leverage** to the maximum extent allowed where applicable.

TO BE

- Institutions shall calculate the own funds requirements using one of the following approaches:
  a) Look-through, if the institution is able to obtain sufficient information about its individual underlying exposures on a **monthly basis** according to **Art104(7)(a)).**
  b) In case the institution is not able to obtain sufficient information but the institution has knowledge of the content of the mandate of the CIU and is able to obtain daily price quotes for the CIU according to **Art104 (7)(b))** can calculate the own funds requirement by using one of the following:
     i) Considering it as a single equity allocated to the "Other Sector" bucket. In DRC it should be allocated to the bucket "**Unrated**".
     ii) In accordance with the limits set in the mandate and in the relevant law. Same consideration for counterparty credit risk and credit valuation adjustment risk.

     Same consideration for DRC and RRAO **where the mandate allows** it to invest in exposures that shall be subject to those own funds requirements. Same consideration to all positions in the same CIU (shall use same approach **on a stand-alone basis** as a separate ptf).
- Referring to point 1b), institutions shall determine the calculation of the own funds requirements by determining a **hypothetical portfolio** taking into account the leverage to the maximum extent. It should be used also for DRC computation and RRAO. The methodology to determine the hypothetical portfolios **shall be approved** by its competent authority. EBA shall develop RTS to specify **further technical elements** of the methodology to determine the hypothetical portfolios.
- Institutions without adequate data to calculate funds using the look-through approach, may rely on a **third party** to perform such calculation. It can be the depository institution or depository financial institution of the CIU or the CIU management company (Art132(3)(a)). An **external auditor** has confirmed the adequacy of the third party´s data.

1. CIU: Collective Investment Undertakings

Market Risk - Alternative Standardised Approach (3/8)

	AS IS	TO BE
FX Risk Factors (Art.325q)	▪ FX Vega risk factors for options with underlyings that are sensitive to foreign exchange shall be the implied volatilities of exchange rates between the **currency pairs referred to in paragraph 1**.	▪ FX Vega risk factors for options with underlyings sensitive to foreign exchange shall be the implied volatilities of exchange rates between **currency pairs.**
Vega Formula Changes (Art.325s)	▪ Vega risk sensitivity of an option to a given risk factor k as follows: $S_k = \frac{V_i(1{,}01 + vol_k, x, y) - V_i(vol_k, x, y)}{0{,}01}$	▪ Vega formula for S_k is replaced by the following: $S_k = \frac{Vi(0{,}01 + vol_k, x, y) - Vi(vol_k, x, y)}{0{,}01} \cdot vol_k$
JtD Look-Through (Art.325v - ab)	▪ **There was not an explicit reference** to the look-through approach for traded non-securitisation credit and equity derivatives.	▪ For traded non-securitisation credit and equity derivatives shall be determined by applying a **look-through approach**. ▪ Look-through approach for traded securitisation included in the ACTP paragraph is deleted
Risk Weights, buckets & correlations (Art.325ae - ah – ak –as)	▪ **(RW) GIRR**: for inflation risk factor and cross currency basis risk factors, the risk weights should be 1,6%. ▪ **(RW) Credit risk for non-sec and sec ACTP**: there was not a risk exposure assigned to an unrated covered bond. ▪ **(RW) Commodities**: Bucket 3 stays for "Energy - electricity and carbon trading" with a RW of 60%.	▪ **(RW) GIRR**: for inflation risk factor and cross currency basis risk factors, the risk weights should be 1,6% divided by √2. ▪ **(RW) Credit risk for non-sec and sec ACTP**: institutions may assign a risk exposure of an unrated covered bond to bucket 4 or 13 where the institution that issued the covered bond has a credit quality step 1 to 3 or 4 to 6 respectively. ▪ **(RW) Commodities**: Bucket 3 stays for "Energy-electricity" and there is a new bucket "3a" for "Energy-carbon trading" with a RW of 40%.

Market Risk - Alternative Standardised Approach (4/8)

Risk Weights, buckets & correlations
(Art.325ai P1 - aj)

AS IS

- **Intra-bucket correlations for credit risk for non-sec**: ρkl (name) shall be equal to 1 where the two names of sensitivities are identical; otherwise it shall be equal to 35%.
- **Correlations across buckets for credit risk for non-sec**: γbc (rating) shall be equal to:
  - 1 if buckets have the same credit quality category (either credit quality step 1 to 3 or credit quality step 4 to 6). Otherwise 50%. (Bucket 1 shall be considered as credit quality step 1 to 3).

TO BE

- **Intra-bucket correlations for credit risk for non-sec**: ρkl (name) shall be equal to 1 where the two names of sensitivities are identical; it shall be equal to 35 % where the two names of sensitivities are in buckets 1 to 18 in Art 325ah(1), Table 4, otherwise it shall be equal to 80%
- **Correlations across buckets for credit risk for non-sec**: γbc (rating) shall be equal to:
  - 1 if buckets are 1 to 17 and both have same credit quality category (steps 1 to 3 or 4 to 6). Otherwise 50%. (Bucket 1 shall be considered as credit quality step 1 to 3).
  - 1 if some of the buckets are 18.
  - 1 if one is bucket 19 and the other has credit quality step 1 to 3. Otherwise 50%.
  - 1 if one bucket is 20 and the other has credit quality step 4 to 6. Otherwise 50%

Market Risk - Alternative Standardised Approach (5/8)

AS IS	TO BE

Scope and structure of the ASA[1]
(Art.325c P1, 3, 4, 5 – Art. 325t)

AS IS

N/A

TO BE

- In order to monitor and ensure compliance with the requirements of ASA, institutions shall have in place and make available to the competent authorities:
  - **A documented set of internal policies.**
  - **Procedures and controls.**
- Institutions shall have a risk control unit (independent from business trading units) reporting directly to senior management. It shall produce and analyze **monthly reports** on the output of the ASA as well as the appropriateness of the institution´s trading limits.
- Institutions shall **independently review** the ASA either as part of their regular **internal auditing process** or by mandating a **third-party** undertaking.
- The review shall cover both the activities of the business trading units and of the independent risk control unit having access to:
  - Internal policies, procedures and controls.
  - Adequacy of the documentation of the risk management system and processes and the organization of the risk control unit.
  - Accuracy of sensitivity computation referred in Art 325t.
  - Verification process that institutions employs to evaluate the consistency, timeliness and reliability of the data sources (including the independence of those data sources).
- Institutions shall conduct the review **at least one a year** or on a less frequent basis upon the approval of the competent authorities.

[1] ASA: Alternative Standardised Approach

Market Risk - Alternative Standardised Approach (6/8)

	AS IS	TO BE
Treatment of CIU[1] (Art.325j P1, 4, 6, 7)	N/A	▪ Institutions shall calculate the own funds requirement using one of the following approaches: – Look-through, if the institution is able to obtain sufficient information about the individual underl. exposures on a monthly basis (Art 104(7)(a)). – In case the institution is not able to obtain sufficient information but the institution has **knowledge of the content** of the mandate of the CIU and is able to obtain **daily price quotes** for the CIU (Art104 (7)(b)) can calculate: a) Considering it as a single equity allocated to the "**Other Sector**" bucket. In DRC it should be allocated to the bucket "**Unrated**". b) b) In accordance with the limits set in the mandate and in the relevant. Considering that Institutions may calculate the own funds requirements for counterparty credit risk and for credit valuation adjustment risk of derivative positions of the CIU using the simplified approach (Art 132a(3)). ▪ Referring to point 1b), institutions shall determine the calculation of the own funds requirements by determining a **hypothetical portfolio** taking into account the leverage to the maximum extent. It should be used also for DRC computation and RRAO. The methodology to determine the hypothetical portfolios **shall be approved** by its competent authority. ▪ Institutions without adequate data to calculate funds using the look-through approach, may rely on a **third party** to perform such calculation. It can be the depository institution or depository financial institution of the CIU or the CIU management company (Art 132(3)(a)). An **external auditor** has confirmed the adequacy of the third party´s data. ▪ EBA shall develop RTS to specify further technical elements of the methodology to determine the hypothetical portfolios.

1. CIU: Collective Investment Undertakings

Market Risk - Alternative Standardised Approach (7/8)

	AS IS	TO BE
FX Risk Factors (Art.325q)	N/A	▪ FX vega risk factors for options with underlyings sensitive to foreign exchange shall be the implied volatilities of exchange rates between **currency pairs.**
Vega Formula Changes (Art.325s)	N/A	▪ Vega formula for S_k is replaced by the following: $$S_k = \frac{V_i(0.01 + vol_k, x, y) - V_i(vol_k, x, y)}{0.01} * vol_k$$
JtD Look-Through (Art.325v - ab)	N/A	▪ For traded non-securitisation credit and equity derivatives shall be determined by applying a **look-through approach**.
Risk Weights, buckets & correlations (Art.325ae - ah – ak –as)	N/A	▪ **(RW) GIRR**: for inflation risk factor and cross currency basis risk factors, the risk weights should be 1,6% divided by √2. ▪ **(RW) Credit risk for non-sec and sec ACTP**: institutions may assign a risk exposure of an unrated covered bond to bucket 4 or 13 where the institution that issued the covered bond has a credit quality step 1 to 3 or 4 to 6 respectively. ▪ **(RW) Commodities**: Bucket 3 stays for "Energy-electricity" and there is a new bucket "3a" for "Energy-carbon trading" with a RW of 40%.

Market Risk - Alternative Standardised Approach (8/8)

Risk Weights, buckets & correlations
(Art.325ai P1 - aj)

AS IS	TO BE
N/A	See below

TO BE

- **Intra-bucket correlations for credit risk for non-sec**: ρkl (name) shall be equal to 1 where the two names of sensitivities are identical; it shall be equal to 35 % where the two names of sensitivities are in buckets 1 to 18 in Art 325ah(1), Table 4, otherwise it shall be equal to 80%
- **Correlations across buckets for credit risk for non-sec**: γbc (rating) shall be equal to:
  - 1 if buckets are 1 to 17 and both have same credit quality category (steps 1 to 3 or 4 to 6). Otherwise 50%. (Bucket 1 shall be considered as credit quality step 1 to 3).
  - 1 if some of the buckets are 18.
  - 1 if one is bucket 19 and the other has credit quality step 1 to 3. Otherwise 50%.
  - 1 if one bucket is 20 and the other has credit quality step 4 to 6. Otherwise 50%

Market Risk - FRTB Internal Model Approach

	AS IS	TO BE
PLAT	N/A	▪ EBA to develop RTS specifying the criteria to determine if **changes in value are either close or sufficiently close to the value of a trading desk's portfolio. It would replace the current RTS.**
Model-lability	N/A	▪ EBA shall develop draft regulatory technical standards to **specify the criteria to assess the modellability of risk factors** in accordance with paragraph 1, including where market data referred to in paragraph 2b are used, and **the frequency of that assessment. It would replace the current RTS.**
Data Inputs for the model	N/A	▪ EBA shall develop draft regulatory technical standards to specify the criteria for the use of **data inputs in the risk-measurement** model referred to in this Article, including criteria on **data accuracy and criteria on the calibration of the data inputs where market data is insufficient. It would replace current guidelines**.
NMRF in Backtesting	N/A	▪ EBA to develop RTS specifying conditions and the criteria related to a backtesting breach which is attributable to a **non-modellable risk factor.**
Backtest Breaches	N/A	▪ **Additional flexibility** in Backtesting introduced for supervisors.
TB & BB	N/A	▪ New criteria used to **assign positions to the TB or to BB introduced** (Art 104) and new requirements for reclassification of a position (104a).

Credit Valuation Adjustment risk framework (1/3)

- After the financial crisis, the **BCBS introduced in 2011 new standards to calculate capital requirements for CVA risk**, as part of the first set of Basel III reforms, to ensure that banks' CVA risk would be covered with sufficient capital in the future. **Transposed to EU law in 2013**.
- Banks and supervisors expressed **concern that the 2011 standards did not adequately reflect the actual CVA risk** banks were exposed to. These concerns focused on:
- For this reason, in order to address those concerns, the **BCBS published revised standards in December 2017** and further adjusted their calibration in July 2020, as part of the final Basel III reforms. As a consequence, **CRR3 proposal incorporates significant changes in the CVA calculation methodology approaches** with respect to CRR2.

	AS IS	TO BE
Meaning (Art.381)	▪ "**Credit valuation adjustment**" or "**CVA**" means an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects the current market value of the credit risk of the counterparty to the institution but does not reflect the current market value of the credit risk of the institution to the counterparty.	▪ Inclusion of the definition of "**CVA Risk**" *as the risk of losses arising from changes in the value of CVA, calculated for the portfolio of transactions with a counterparty, due to movements in a counterparty's credit spreads risk factors and in other risk factors embedded in the portfolio of transactions.*
Scope (Art.382)	▪ CVA scope limited to all **OTC derivative instruments**, other than credit derivatives recognized to reduce risk-weighted exposure amounts for credit risk. ▪ **Securities financing transactions** are included in the scope as long as the competent authority determines a materiality on the exposures of these transactions. ▪ Article 382.4 details the **list of transactions** that are subject to **exemption** for the calculation of CVA	▪ **Inclusion of fair-valued securities financing transactions**[1] that imply materiality as scope to the own funds requirements for CVA risk. ▪ **Possibility to include** in the computation of CVA also the non–financial counterparties exluded in the Art.382 (4) ▪ **New provision requiring institutions to report the results for transactions exempted**[2] of the calculation of CVA risk in accordance with the list stated in the article. Discretion for institutions that **hedge the CVA risk of those exempted transactions** to calculate CVA risk for those transactions, taking into account the eligible hedges concerned. ▪ **Article 382a is inserted** to set out the new approaches institutions should use to calculate their own funds requirements for CVA risk and **conditions for combining different approaches**.

1. Development of ECB guidelines required to identify excessive CVA risk and specify conditions for assessing the materiality of CVA risk exposures from fair-valued SFTs
2. Requirements set out in the regulation have been largely transferred from those developed by the BCBS CVA Framework Paper

Credit Valuation Adjustment risk framework (2/3)

	AS IS	TO BE

Standardized Approach (Art.383)

AS IS

- The current SA-CVA is called "**advanced method**", and is applied using the LGD and EE of the counterparties and no aggregations of sensitivities are used for the capital calculation.

$$CVA = LGD_{MKT} * \sum_{i=i}^{T} max\left\{0, e^{\left(-\frac{S_{i-1}*t_{i-1}}{LGD_{MKT}}\right)} - e^{\left(-\frac{S_i*t_i}{LGD_{MKT}}\right)}\right\} * \frac{EE_{i-1} * D_{i-1} + EE_i * D_i}{2}$$

TO BE

- **Article 383 is replaced** to introduce the general requirements for using the "**standardised approach**" or **SA-CVA** for calculating the own funds requirements for CVA risk, when granted permission from the authorities, as well as the definition of regulatory CVA for that purpose, and transferring the requirements set forth in the **BCBS CVA framework paper (MAR50).**
- **Articles 383a to 383x** specify the technical elements of the SA:
    1. Regulatory CVA model
    2. Own fund requirements for Delta and Vega risks
    3. Risk factors specifications
    4. Risk Weights and Correlations

Basic Approach (Art.384)

AS IS

- The current BA-CVA is called "**standardized method**", and is applied when the institution cannot use the "advanced method" (current SA-CVA), as stated in Article 384.1, and taking into account CVA hedges that are eligible.

$$K = 2.33 * \sqrt{h} * \sqrt{\left(\sum_i 0.5 * w_i * \left(M_i * EAD_i^{total} - M_i^{hedge} * B_i\right) - \sum_{ind} w_{ind} * M_{ind} * B_{ind}\right)^2 * \sum_i 0.75 * w_i^2 * \left(M_i * EAD_i^{total} - M_i^{hedge} * B_i\right)^2}$$

TO BE

- **Article 384 is replaced** to introduce the "**basic approach**" or BA-CVA for calculating the own funds requirements for CVA risk, in line with the Basel III. There are two possible approaches:
    - **Including** the eligible hedges:

$$BACVA^{total} = DS_{CVA} * (\beta * BACVA^{csr-unhedged} + (1-\beta) * BACVA^{csr-hedged}$$

- **Non including** the eligible hedges

$$BACVA^{csr-unedged} = \sqrt{\left(\rho \cdot \sum_c SCVA_c\right)^2 + (1-\rho^2) \cdot \sum_c SCVA_c^2}$$

Simplified Approach (Art.385)

AS IS

- As an alternative to the previous approaches, the regulation propose to use the "**original exposure method**", defined for the calculation of counterparty credit risk in Article 275 CRR.
- A **multiplication factor of 10** is applied to the resulting risk-weighted exposure amounts for counterparty credit risk for those exposures instead of calculating own funds requirements for CVA risk

TO BE

- **Article 385 is fully replaced** to introduce the "**simplified approach**" for calculating the own funds requirements for CVA risk if Art. 273a (2) conditions are met by the institution.
- **Inclusion of eligibility criteria** for the use of this simplified approach:
    - Only transactions subject to the own funds requirements for CVA risk laid down in Article 382 shall be subject to that calculation
    - Credit derivatives that are recognized as internal hedges against counterparty risk exposures shall not be included in that calculation

Credit Valuation Adjustment risk framework (3/3)

Eligible Hedges (Art.386)

AS IS

- Delimitation of the instruments of eligible hedges (art 383 and 384) to the following:
  - Single-name CDS or equivalent hedging instrument referencing the ctpy directly.
  - Index CDS, provided that the basis between any individual ctpy spread and the spreads of index credit default swap hedges is reflected.
  - Proxy specifications and over-hedging exposures of single name CDS under Art. 384 not allowed.
- Exclusion from the market risk calculation of hedges determined as eligible, or treated as CR mitigation other than for the counter party credit risk of the same portfolio of transaction.

TO BE

- **New requirements applicable to eligible hedges for the purposes of the own fund requirements for CVA risk**:
  - Used for mitigating CVA risk
  - Can be entered into with 3rd parties or with Trading Book as internal hedged (if complies Art. 106(7))
  - Only positions in hedging instruments as per parr 2 and 3
  - A given hedging instrument forms a single position and cannot be splitted
- **New classification of positions recognised as eligible hedges** based on the type of hedging instruments differentiating for Art 383 and 384, exceptions as per Art 325(5).
- **Positions in hedging instruments recognized as eligible hedges** based on parr. 1, 2 and 3 included in CVA own funds calculation, **not subject to own funds for market risk**.
- On the other hand, positions not recognized as eligible hedges shall be subject to own fund requirements for market risk.

Operational risk (1/3)

- All existing approaches for the calculation of the own funds requirements for operational risk are replaced by a single non-model-based approach to be used by all institutions.
- The forthcoming approach is based on an indicator of the institution's business size (Business Indicator), weighted by a coefficient ranging from 12% to 18% - according to institution's size – to compute the Business Indicator component (BIC). Leveraging jurisdictional discretion, CRR3 proposal dismisses the use of historical loss for regulatory capital computation
- However data collection and governance rules are now introduced:
  - institutions with a business indicator equal to or above EUR 750 million also have to disclose historical loss data, and the loss data set should be calculated in accordance to qualifying criteria closely aligned to current AMA requirements
  - Operational risk management framework should meet qualitative criteria currently in place for TSA and AMA approaches
- No phase-in is foreseen. Institutions will compute Pillar 1 capital requirement solely as the BIC from 2025

Calculation of own funds (Art.312-315)

AS IS

- Current approaches for regulatory capital calculation include both volume based indicators (BIA and TSA) and more risk sensitive internal models (AMA) with historical data, scenarios and business environment and control factors as input. Institutions opt for their approach according to their desired level of sophistication and precision in measuring operational risk
- Simpler approaches (BIA and TSA) are based on Gross Income, i.e. on net interest income and net fee income

TO BE

- No internal model allowed for pillar I, but institutions can still use/develop them for pillar II
- A one-size-fit-all Standardized Approach (SA) is introduced. Capital will be proportional to business volume (sum of interest, service and financial income components). No role for historical data
- The definition of BIC (as compared to gross income currently used for calculating the more simple Pillar 1 approaches) entails the removal of netting rules for financial profit vs. loss and commission income vs. commission expenses. This could drives higher capital requirements for some business activities (e.g. commission based business).

Operational risk (2/3)

Loss Dataset calculation and review (Art.316-322)

AS IS

- Requirements and scope of Loss Data Collection (LDC) strongly differs according the regulatory approaches:
  - BIA: no requirement of data collection
  - TSA: only tracking relevant operational risk data, including material loss data is required
  - AMA: complete, detailed and sound collection and update of data is required
- Only AMA institutions have a minimum collection period of at least five years. No minimum requirement for BIA and TSA approaches
- BIA and TSA approaches do not foresee any requirement about IT infrastructure supporting LDC
- BIA and TSA approaches do not foresee any requirement about independent review of loss data collection processes and systems
- Regulatory reporting entails just yearly aggregated loss amount for TSA and AMA (Corep). No loss disclosure under BIA approach

TO BE

- Institutions with a BI ≥ EUR 750 mln shall establish on ongoing basis a loss data set, by recording each operational risk event and its attribute (gross loss, insurance and not insurance recovery, reference dates, grouping) and mapping to type of events.
- LDC scope is closely aligned to current AMA criteria, as it is required to collect also provisions, boundary, pending and timing losses.
- Institutions shall update the net loss calculation for each of the last ten financial years and shall take into account from the loss data set operational risk events with a net loss ≥ EUR 20k. A separate reporting of net losses ≥ EUR 100k is also required.
- Exceptional no longer relevant operational risk events may be excluded if certain conditions are met.
- CRR 3 sets out several soundness and resilience requirements over the development and management of the IT infrastructure supporting LDC.
- Competent authorities shall carry out review the quality of loss data at least every three years for an institution with a business indicator above EUR 1bn
- An independent review of the quality of the loss data is required

Operational risk (3/3)

ORM framework (Art.323)

AS IS

- Requirements over the ORM framework strongly differs according the regulatory approaches:
  - BIA: no criteria required
  - TSA: process requirements related to
    - ➢ clearly assigned roles and responsabilities for the management of operational risk
    - ➢ tracking of relevant operational risk data, including material loss data
    - ➢ a system of reporting to senior management
  - AMA: additional qualitative requirement mainly related to
    - ➢ independence of operational risk function
    - ➢ capability of oversight the operarational risk exposure
    - ➢ independent review of management and measurement process of operational risk

  and quantitative requirements related to the use of the four AMA components (internal and external data, scenario analysis, business environment and internal control factors), as detailed in Commission delegated regulation (EU) 2018/959

TO BE

- CRR 3 proposal extends to all institutions current TSA and qualitative AMA requirements to all institutions, including, among all:
  - a well-documented assessment and management system for operational risk, closely integrated into the day-to-day risk management processes
  - An assessment and management system for operational risk that shall identify the institution's exposures to operational risk and track relevant operational risk data, including material loss data;
  - a system of regular monitoring and reporting of operational risk exposures and loss experience, and procedures for taking appropriate corrective actions
  - internal validation processes and regular reviews of the institution's operational risk assessment and management processes and systems, performed by internally or by the auditor
  - proper data flows and processes supporting the operational risk assessment system
- As a consequence, not only LDC, but also other traditional ORM framework components such as Risk assessment, scenario analysis, KRI and even measurement could be instrumental under the new Standardised Approach

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