



EUROPEAN COMMISSION

Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Call for advice to the EBA for the purposes of revising the own fund requirements for credit, operational, market and credit valuation adjustment risk

Context

On 7 December 2017, the Group of Governors and Heads of Supervision (GHOS) endorsed a package of amendments aimed at finalising the "Basel III framework"¹, the internationally agreed prudential standards for banks developed by the Basel Committee on Banking Supervision (BCBS) adopted in the wake of the financial crisis. The package includes the following key revisions²:

- (i) revisions to the standardised approach for credit risk (SA-CR);
- (ii) revisions to the internal ratings-based approaches (IRBAs) for credit risk;
- (iii) an overhaul of the credit valuation adjustment (CVA) framework;
- (iv) a new standardised approach for operational risk (SA-OR), which replaces all existing approaches for this risk; and
- (v) the replacement of the "Basel II" floor³ with an aggregate output floor.

BCBS members agreed to full, timely and consistent implementation of all elements of the package by 1 January 2022 with the exception of the output floor, where the transitional arrangements include a phased-in implementation until 1 January 2027. The implementation of the agreement in the EU would require amendments to existing EU legislation, predominantly to Regulation (EU) No 575/2013 (the Capital Requirements Regulation or CRR).

¹ BCBS (2017) "Basel III: Finalising post-crisis reforms" (BCBS/2017/D424), available at: <https://www.bis.org/bcbs/publ/d424.pdf>.

² Two additional elements of the package of reforms, namely the final revisions to the measurement of the leverage ratio and the introduction of a leverage ratio buffer for global systemically important banks (G-SIBs) are currently being discussed as part of the negotiations on the package of amendments to Regulation (EU) No 575/2013 and Directive 2013/36/EU proposed by the Commission in November 2016 (the "Banking Package"). These elements are therefore not further considered in the present Call for Advice.

³ The Basel II framework ("International Convergence of Capital Measurement and Capital Standards", available at: <https://www.bis.org/publ/bcbs128.pdf>) introduced an output floor based on Basel I capital requirements.

The GHOS also extended the implementation date of the revised market risk framework adopted by the BCBS in January 2016, known as the Fundamental review of the Trading Book (FRTB), to 1 January 2022, in order to allow banks additional time to develop the necessary systems infrastructure but also to give the BCBS additional time to address certain specific issues related to the framework. As regards the latter, the BCBS published, on 22 March 2018, a consultation document including a number of proposed revisions to the FRTB.

As part of the implementation⁴ process, the Commission services are seeking technical advice from the EBA to assess i) the potential impact of the various elements of the package of reforms published in December 2017 by the BCBS, as well as the final FRTB standards, on the EU banking sector and the wider economy, and ii) possible implementation challenges which would arise for institutions established in the EU.

Scope of the EBA's work

General considerations

In this context the Commission services would like to invite the EBA to provide all information considered relevant to inform the Commission's decision on the implementation of the revisions.

In particular, the EBA is invited to assess the individual impact on institutions of introducing each of the abovementioned key revisions in EU legislation (as set out in more detail in the specific sections below) as well as the combined impact of all those revisions. Those impacts should be assessed in comparison to the situation under the existing EU legislation (the latter should constitute the general "baseline" for the comparison, unless specified differently in the below sections). Where possible and not otherwise specified, the EBA may complement quantitative analysis with qualitative analysis.

The EBA's assessment should cover both the impact in terms of changes to the own funds and eligible liabilities requirements of institutions but also in terms of the operational and administrative costs that would be incurred by institutions.

The impacts requested in terms of changes to the institutions' own funds and eligible liabilities requirements should at least be expressed in terms of changes to risk-weighted assets (RWAs), capital ratios, Tier 1 minimum required capital (MRC) as well as any resulting shortfalls in own funds/eligible liabilities, if applicable. In this context, the EBA should consider all own funds and buffer requirements (i.e. Pillar 1, Pillar 2 and combined buffer) as applicable under the CRR and Directive 2013/36/EU (the Capital Requirements Directive or CRD) as well as the (forthcoming) MREL/TLAC⁵ requirements. When assessing these impacts, the EBA should take into account institutions' ability to retain profits and increase own funds/eligible liabilities during the implementation period.

⁴ As previously announced by the Commission, any legislative proposal to implement the outstanding Basel III reforms would be independent from the Banking Package.

⁵ Respectively, the Minimum Requirement for own funds and Eligible Liabilities and the Total Loss-Absorbing Capacity.

The EBA should explain, on a best efforts basis, the main drivers behind at least the most significant impacts.

The impacts should be clustered with respect to the size, location⁶ and business model (e.g. universal, custodian, cooperative, savings, pass-through banks, etc.)⁷ of the institutions, where relevant. As regards the size criteria, the EBA should determine the appropriate classification in accordance with criteria that the EBA would find relevant and should use that classification consistently across the report. In addition, the EBA should cluster some impact in accordance with the following prescribed classifications:

- (i) G-SIIs, O-SIIs, institutions other than G-SIIs and O-SIIs for the combined impact of introducing all the revisions;
- (ii) small institutions, large institutions, institutions other than small and large institutions, in accordance with the same definitions proposed by the Estonian Presidency in the Progress Report⁸ on the Banking Package when assessing the administrative and operational impacts of the individual revisions.

The EBA should also opine on whether, looking at the European banking sector as a whole, any significant shifts to or from certain types of activities, exposures, business lines or business models would be expected following the introduction of any of the revisions.

Specific considerations

1. Standardised approach for credit risk framework

1.1. General information

The report should provide an overview of institutions' current use of the SA-CR and the corresponding own funds requirements per exposure class. In particular, the report should include information on:

- (i) the overall size of credit risk activities under the SA-CR (as a share of the total credit exposure, total assets and other relevant metrics);
- (ii) the own funds requirements associated with the activities referred to in point (i) under the SA-CR in the EU (both total and broken down by exposure class);
- (iii) the portion of exposures for which risk-weights (RWs) are determined by the use of external credit ratings.

⁶ In this context the EBA should not only look at the impact of the revisions at the consolidated level but also specifically assess the impact on subsidiaries of cross-border banking groups in host Member States.

⁷ It is noted that previous EBA reports, such as the one on Net Stable Funding Requirements, provided a break-down according to business models. Hence the EBA could apply existing classifications of business models, if relevant, when responding to this call or advice.

⁸ See new Article 430a of the CRR, available at: <http://data.consilium.europa.eu/doc/document/ST-14891-2017-INIT/en/pdf>.

1.2. Capital impact

The report should provide an estimation of the impact of implementing the amendments to the SA-CR. Estimates on the impact should be provided (i) for each of the amendments (as further specified below under 1.4.1.-1.4.10.) separately and including a break-down per exposure class as well as (ii) for the revised SA-CR as a whole.

1.3. Implementation/operational/administrative impact

The EBA's report should provide an assessment of the implementation, operational and administrative costs/benefits for institutions to implement the revised SA-CR, with special reference to the implementation of and compliance with (i) the strengthened due diligence requirements and (ii) the eligibility criteria⁹ for real estate (such as in particular the valuation requirements for property for the purposes of calculating the loan-to-value (LTV) ratio). In this assessment, the report should distinguish between one-off and recurring costs/benefits.

The report should put particular emphasis on the application of the proportionality principle and explore possible simplifications in order to reduce the burden particularly on small non-complex institutions and on institutions with specific business models.

1.4. Individual amendments

1.4.1. External credit risk assessment approach (ECRA) vs standardised credit risk assessment approach (SCRA)

The revised SA-CR retains the use of external ratings for exposures to institutions and corporates (termed ECRA), with alternative approaches for unrated exposures and for jurisdictions that do not allow the use of external ratings for regulatory purposes (termed SCRA). In its report the EBA is invited to compare to the extent possible the costs/benefits of implementing in the EU the ECRA or the SCRA.

1.4.2. Exposures to institutions

With regards to exposures to rated institutions, the EBA should assess in its report the impact that would result (i) from the revised RWs and (ii) to the extent possible, the challenges associated with the new requirement under the ECRA that the ratings to be used must not incorporate assumptions of implicit government support, unless the rating refers to a public bank owned by its government.

With regards to exposures to unrated institutions, in addition to assessing the impact that would result from the revised approach, the report should, to the extent possible, provide information on the distribution of exposures to Grade A, B and C under the SCRA¹⁰.

1.4.3. Exposures to corporates

With regards to exposures to rated corporates, the EBA should assess the impact that would result from the revised RWs under the ECRA and compare it with a scenario

⁹ As set out in paragraph 60 of BCBS/2017/D424.

¹⁰ As set out in paragraphs 21 to 31 of BCBS/2017/D424.

where the SCRA would be implemented instead. With regards to exposures to unrated corporates, the report should, to the extent possible, provide an estimation of the own funds and operational impact that would result from the implementation of the SCRA. Furthermore, the EBA is invited to consider whether a combination of the ECRA (for rated exposures) and the SCRA (for unrated exposures) would be appropriate to increase the risk-sensitivity of the framework.

With regard to exposures to unrated corporate small and medium-sized enterprises (SMEs) the EBA should assess the impact that would result from implementing the new definition of “corporate SMEs” and the revised RW of 85%. When assessing the impact, the EBA should also include a scenario (in addition to the comparison of the revised Basel standard with the baseline which includes the so-called “SME supporting factor”) where the amendments to the CRR proposed by the Commission in the Banking Package (specifically the amendments to Article 501 which extend the scope of the existing SME supporting factor) would apply.

With regard to specialised lending, the EBA should assess the impact that would result from implementing the various subcategories¹¹ envisaged by the revised standard. When assessing the impact, the EBA should also include a scenario (in addition to the comparison of the revised Basel standard with the baseline) where the amendments to the CRR proposed by the Commission in the Banking Package (specifically the proposed new Article 501a which adjusts the capital requirements for credit risk for exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services) would apply.

1.4.4. Subordinated debt, equity and other capital instruments

The EBA should assess the impact that would result from implementing the revised RWs for (i) equity exposures (taking into account, to the extent possible, the envisaged phase-in arrangements¹²) and (ii) subordinated debt and capital instruments other than equities.

With regard to equities, the report should include a break-down of the estimated impact on the three sub-categories¹³ envisaged by the revised standard and assess their sensitivity to variations of the RWs (e.g. ranging from 100% to 250% and from 250% to 400%). The analysis should consider the impact of implementing the revised treatment for (i) equity exposures currently classified as ‘high-risk items’ under Article 128 of the CRR, (ii) private equity exposures in sufficiently diversified portfolios according to Article 155(2) of the CRR and (iii) holdings of own funds instruments that are currently risk-weighted in accordance with Article 49(4)¹⁴ of the CRR. In this context, the EBA is invited to consider whether further clarification or refined criteria are needed to adequately reflect the riskiness of different types of equity holdings existing in the EU.

¹¹ I.e. (i) project finance in the pre-operational phase and (ii) in the operational phase (iii) including high quality project finance, (iv) object finance and (v) commodities finance (see paragraph 44 ff of BCBS/2017/D424).

¹² As set out in footnote 29 of BCBS/2017/D424.

¹³ I.e. speculative unlisted equity exposures, other equity holdings and equity holdings made pursuant to national legislated programmes.

¹⁴ With regard to (iii) the impact of the revised RWs should be assessed separately for the three cases set out in paragraph 1, 2 and 3 Article 49 CRR.

1.4.5. Retail exposures

With regard to “regulatory retail exposures”, the report should provide an analysis of the costs/benefits of implementing the “granularity criterion” of 0.2%¹⁵ or any (other) alternative measure that the EBA may consider appropriate to ensure satisfactory diversification of regulatory retail portfolios, especially for small institutions.

The report should also provide information on the materiality of the impact of introducing the sub-category of “transactors”¹⁶ and on its relative importance within the regulatory retail exposures class.

1.4.6. Exposures secured by mortgages

The report should, to the extent possible, provide a comparison of the costs/benefits of implementing in the EU the “whole loan approach”¹⁷ or the “loan-splitting approach”¹⁸ for the purposes of determining the applicable RWs for exposures secured by residential (RRE) or commercial real estate (CRE).

In its report the EBA should assess the impact that would result from implementing the revised RWs for (i) general RRE and (ii) income-producing RRE as well as for (iii) general CRE and (iv) income-producing CRE, assuming the existing “hard test requirements”¹⁹ would be maintained.

In this context, the report should include a quantitative or qualitative assessment of the impact of the revised approach for the purposes of the property valuation under the revised standard, including with regards to any possible cyclical effects. Furthermore, the EBA is invited to consider whether there is sufficient rationale to supplement LTV ratios with other factors, such as the loan-to-income ratio, the debt-service-coverage ratio or the rate type of a loan, for the purposes of determining the RWs applicable to exposures secured by mortgages.

1.4.7. Land acquisition, development and construction (ADC) exposures

In its report the EBA should assess the impact that would result from implementing the new class of ADC exposures²⁰. In this context, the report should provide information on the relative size of ADC exposures (as a share of total credit exposures) including a breakdown of exposures that would receive a RW of 150%²¹ and exposures that could receive a RW of 100%²². With regard to the latter sub-category, the EBA is invited to analyse the risk-sensitivity of the conditions for applying the 100% RW considering also the criteria currently applied in the EU for distinguishing non-speculative from speculative immovable property financing²³.

¹⁵ As defined in paragraph 55 of BCBS/2017/D424.

¹⁶ As defined in paragraph 56 of BCBS/2017/D424.

¹⁷ As set out or referred to in paragraphs 64, 67, 70 and 73 of BCBS/2017/D424.

¹⁸ As set out or referred to in paragraphs 65, 71 and 73 of BCBS/2017/D424.

¹⁹ See footnote 49 of BCBS/2017/D424 and Articles 125(3) and 126(3) of the CRR, respectively.

²⁰ As set out or referred to in paragraphs 74 and 75 of BCBS/2017/D424.

²¹ As specified in paragraph 74 of BCBS/2017/D424.

²² As specified in paragraph 75 of BCBS/2017/D424.

²³ As defined in Article 4(1)(79) of the CRR.

1.4.8. RW multiplier to certain exposures with currency mismatch

The EBA should assess, qualitatively or quantitatively, the impact that would result from implementing the RW multiplier for certain unhedged retail and RRE exposures to individuals where the lending currency differs from the currency of the borrower's source of income²⁴.

1.4.9. Off-balance sheet items

The EBA should assess the impact that would result from implementing the revised credit conversion factors (CCFs) including with regards to the leverage ratio (LR)²⁵. Where they are considered material, estimates should be provided for each CCF separately and should at least cover the revised CCF for unconditionally cancellable commitments and trade finance transactions.

1.4.10. Credit Risk Mitigation (CRM)

The EBA should assess the global and, to the extent possible, individual impacts that would result from implementing the main changes made to the CRM framework, including (i) the recalibrated supervisory haircuts under the comprehensive approach and (ii) the removal of the use of own-estimates of haircuts under that approach, (iii) the recognition of credit derivatives that do not cover restructuring where restructuring is not specified as a credit event²⁶ and (iv) the removal of the use of nth-to-default credit derivatives as an eligible CRM technique (for changes pertaining to the use of securities financing transactions (SFTs) see section 3).

2. Internal ratings-based approaches (IRBAs) for credit risk

2.1. General information

The report should provide an overview of institutions' use of the Foundation IRB approach (F-IRBA) and the Advanced IRB approach (A-IRBA) and their current own funds requirements per exposure class. In particular, the report should include information on (i) the overall size of credit risk activities under the F-/A-IRBA (as a share of total credit exposure and other relevant metrics such as RWAs and exposure at default [EAD]), (ii) their composition by exposure class, and (iii) the associated own funds requirements under the existing rules on F-/A-IRBA.

2.2. Capital impact

The report should provide an estimate of the impact that implementing the amendments to the IRBAs in the EU would have on institutions' own funds and own funds requirements (as specified above). Estimates on the impact should be provided (i) for each of the amendments specified below separately applying a sequenced approach

²⁴ As set out in paragraphs 76 and 77 of BCBS/2017/D424.

²⁵ The CCFs are also referred to in the calculation of the LR for the determination of the leverage exposure for determining off balance sheet items; increasing CCFs will therefore also impact the LR.

²⁶ As specified in footnote 83 of BCBS/2017/D424.

where appropriate and including a break-down per exposure class as well as (ii) for the revised IRB framework as a whole.

2.3. Implementation/operational/administrative impact

The report should provide a broad assessment of the implementation, operational and administrative costs/benefits for institutions to implement the revised F-/A-IRBA. In this assessment, the report should distinguish between one-off and recurring costs/benefits.

2.4. Individual amendments

2.4.1. Scope of application of the IRBAs

Under the revised standard the A-IRBA would no longer be available for exposures to institutions and other financial institutions and for exposures to corporates with consolidated revenues above €500 million per year. Equity exposures would be exclusively treated under the SA-CR.

In its report the EBA should assess the impact of each of these changes for each exposure class and its types, where applicable²⁷.

2.4.2. Deletion of the 1.06 IRB scaling factor

The report should provide an estimate of the impact that would result from removing the 1.06 scaling factor which is currently applied to RWAs determined by the IRBA.

2.4.3. Floors for own estimates of probability of default (PD) and loss-given-default (LGD) ("input floors")

The report should provide an estimate of the impact of the input floors that the revised Basel standards would introduce for PD and LGD estimates. The impact should be provided separately for PD and LGD and for A-IRBA and F-IRBA, as relevant.

2.4.4. Regulatory values for LGDs and CCFs

The EBA should estimate the impact of implementing the revisions to the regulatory values for LGDs and CCFs, including the revised calculation of LGDs for secured exposures. The estimates should be provided separately for LGDs and CCFs.

2.4.5. CRM

In its report the EBA should assess the impact that would result from removing the use as eligible CRM technique of (i) conditional guarantees and (ii) nth-to-default credit derivatives for non-retail exposures under the A-IRB.²⁸

²⁷ See paragraphs 5 ff of BCBS/2017/D424 and Article 147 CRR; for example, exposures to public sector entities which are not treated as exposures to central governments in accordance with Article 116(4) are assigned to the class of exposures to institutions (Article 147(4)(b) CRR).

²⁸ As set out in paragraphs 90-97, 122-123, 252-264 of BCBS/2017/D424.

With regard to the new requirement to treat guaranteed exposures under the same approach that the institution applies for direct exposures to the guarantor, the EBA should (i) assess the impact of each of these changes separately for retail and non-retail exposures and, where material/relevant, (ii) the costs/benefits of applying an alternative treatment the EBA may consider appropriate.

2.4.6. Clarifications and other changes in the estimation of PD, LGD, CCF and maturity

In its report the EBA should analyse the overall and, to the extent possible, individual impacts that would result from the implementation of the various clarifications²⁹ included in the revised IRB framework as well as from the other changes in the estimation of risk parameters³⁰. In this context, the EBA should also assess the impact resulting from the application of the revised rules on the effective maturity, in particular if the fixed maturities under the F-IRB approach were applied (instead of the actual maturity). The EBA is invited to present the impacts of these changes individually where material or grouped with related changes.

3. Securities financing transactions (SFTs)

3.1. General information

The report should provide an estimate of the current SFTs positions held by institutions, broken down by collateral type, counterparty type and whether these positions are centrally-cleared or not.

The report should provide an overview of the use of the current approaches for calculating the exposures value of SFT for the counterparty risk framework, including the number of institutions using each approach and the total own funds requirements for counterparty risk held under each approach.

3.2. Capital impact

The EBA should estimate the overall impact of introducing in the EU the revisions adopted by the BCBS in December 2017 to calculate the exposure values of SFTs, including (i) the recalibration of the supervisory haircuts; (ii) the removal of the own estimates of collateral haircuts; (iii) the revision to the standardised formula for the calculation of the exposure value of SFTs covered by a master netting agreement and (iv) the introduction of the minimum haircut floor framework.

Where there are significant impacts, the EBA should explain, on a best effort basis, the main drivers behind those impacts.

²⁹ E.g. the clarification that the maturity of revolving exposures should be the maximum contractual termination date of the facility and not the date of the current drawing (see paragraphs 109 of BCBS/2017/D424).

³⁰ Such as the deletion of the possibility to give unequal importance to historic data for retail exposures (see paragraphs 232-234, 240 of BCBS/2017/D424).

3.3. Implementation/operational/administrative impact

The report should provide a broad assessment of the implementation, operational and administrative costs/benefits for institutions to implement the amendments of the Basel framework related to SFTs, particularly the minimum haircut floor framework. In this assessment, the report should distinguish between one-off and recurring costs/benefits.

3.4. Assessment of the minimum haircut floor framework

In the December 2017 package, the BCBS specifies the treatment of certain non-centrally cleared SFTs with certain counterparties (hereafter "in-scope SFTs"). The revised framework sets out minimum haircut floors and determines that in-scope SFTs which do not meet the haircut floors must be treated as unsecured loans. In its report the EBA should assess the materiality of the in-scope SFT positions currently held by institutions which do and do not comply with the minimum haircut floors separately. The report should provide an estimate of the impact of the minimum haircut floors framework, specifically the potential impact for institutions that do not comply with the minimum haircut floors in relation to their positions in in-scope SFTs under two different scenarios, namely:

- (i) assuming that those institutions would not adjust the haircuts they apply to their positions in in-scope SFTs to comply with the minimum haircut floors; and
- (ii) assuming that those institutions would adjust the haircuts they apply to their positions in in-scope SFTs to comply with the minimum haircut floors.

When estimating these impacts, the EBA should assume that the other revisions adopted by the BCBS in December 2017 to calculate the exposure values of SFTs are applied at the same time.

The EBA should also opine on whether there is already excessive leverage in the EU outside the banking system, to which extent the minimum haircut floors framework would reduce this excessive leverage (or leverage more in general) and whether the introduction of this framework in the EU may have unintended consequences, in particular on the objective of creating a Capital Market Union.

4. Credit valuation adjustment (CVA) risk framework

4.1. General information

The report should provide an overview of institutions' CVA risk as calculated for accounting purposes and institutions' current own funds requirements for CVA risk under the CRR, including CVA risk arising from transactions with the counterparties exempted from the own fund requirements for CVA risk under Articles 382(3) and 382(4) of the CRR.

4.2. Capital impact

The report should provide an estimate of the impact of introducing the revised CVA framework in the EU, taking into account any amendments to the revised CVA framework that would have been adopted by the BCBS before the date by which the EBA should deliver its report, separately for institutions currently using the standardised method and the advanced method under CRR. This estimate should be based on the

scope of transactions currently subject to the own funds requirements for CVA risk under the CRR.

4.3. Implementation/operational/administrative impact

The report should provide a broad assessment of the implementation, operational and administrative costs/benefits for institutions to implement the revised CVA risk framework. In this assessment, the report should distinguish between one-off and recurring costs/benefits.

4.4. Assessment of the revised CVA framework for counterparties exempted from the own fund requirement for CVA risk under CRR

The EU co-legislators introduced a number of exemptions from the own funds requirements for CVA risk under the CRR, mostly covering derivative transactions with counterparties that were exempted from the clearing/margining mandates under Regulation (EU) No 648/2012 (EMIR) (certain non-financial, sovereign, intra-group and pension fund counterparties).³¹ With these exemptions, the EU co-legislators wanted to prevent a potential excessive increase in the cost of derivative transactions for those counterparties due to the introduction of the own funds requirements for CVA risk. However, the CVA risk of the exempted counterparties under the CRR may still be a source of significant risk for some of the institutions that benefit from those exemptions.

In this regard, the EBA should assess the impact of moving from the current CVA risk framework to the revised CVA risk framework for the counterparties exempted under the CRR³².

The EBA should explain, on a best efforts basis, the main drivers behind at least the most significant impacts. The analysis should be carried out separately for each exemption.

The EBA should also identify any potential inconsistencies or interpretational issues with the current definitions of the exemptions set out in Article 382 of the CRR which may prevent a sound identification of the transactions that must be exempted. In case the EBA identifies any such inconsistencies or interpretational issues, it should recommend the most appropriate way to address them.

4.5. Proportionality for CVA

In its report the EBA should also analyse how to apply the proportionality principle under the CVA risk framework.

In this regard, the EBA should consider the appropriateness of allowing institutions with an aggregate notional amount of non-centrally cleared derivatives which is less than or equal to € 100 billion to use the simplified treatment to calculate the own funds

³¹ Collateral exchanges are generally an efficient way to mitigate CVA risks; in their absence, CVA risks (and the own fund requirements for CVA risks) may remain high.

³² The counterparties exempted are by definition not subject to the current CVA risk framework. However, for the sake of calculating the impact of the new CVA framework, institutions would have to compute the current and revised CVA risk frameworks for those exemptions.

requirements for CVA risk³³, as set out in the revised CVA risk framework of the BCBS. In particular, the EBA should assess whether this simplified treatment is sufficiently prudent in the sense that the amount of own funds requirements resulting from it should not be materially lower than the amount of own funds requirements resulting from the BA-CVA (this approach would need to be applied by those institutions in the absence of the simplified treatment) using the current scope of application of the own fund requirements for CVA risk under CRR (i.e. including the exemptions set out in Article 382 of the CRR). If this is not the case, the EBA is invited to recommend ways in which the treatment should be adjusted to ensure its prudence.

As part of this assessment, the EBA should also assess how many institutions in the EU would be eligible under this simplified treatment and whether the abovementioned threshold is an adequate and sufficient measure to identify institutions with supposedly limited CVA risks. If it considers that this is not the case, the EBA should recommend alternative or additional (including relative) thresholds that could be used. In this context, the EBA should provide its views on whether thresholds similar to those that have been proposed in the EU Banking Package for determining the eligibility to use the simplified Standardised Approach for Counterparty Credit Risk and the Original Exposure Method, could be used.

In addition, the EBA should provide an estimate of the number of institutions applying the treatment laid out in Article 385 of the CRR to compute the own funds requirements for CVA risk. In light of the assessment of the appropriateness of the abovementioned simplified treatment introduced by the revised CVA framework, the EBA should also assess the appropriateness of keeping, amending or replacing the treatment laid out in Article 385 of the CRR. Finally, the EBA should assess to which extent institutions that currently use the approach laid out in Article 385 of the CRR would be eligible to use the simplified treatment introduced by the revised CVA framework based on either the abovementioned threshold or the alternative/additional threshold(s) that the EBA may recommend using.

4.6. Definition of CVA under SA-CVA

The EBA should assess, for institutions that intend to use the SA-CVA, the adequacy of the new principle-based definition of CVA under SA-CVA. In particular, the report should estimate to which extent those institutions already comply with those principles, or if it is not the case, what could be the main issues for them to comply with them. The EBA should consider whether some degree of flexibility, or additional specifications, should be provided when translating these principles into EU law to ensure the sound and harmonised application of those principles by institutions that intend to use the SA-CVA.

4.7. Application of the revised CVA framework to Securities Financing Transactions

The revised CVA risk framework requires institutions to calculate an own funds requirement for CVA risk for SFTs measured at fair-value for accounting purposes. The report should assess the materiality of those transactions for institutions and whether implementing this treatment would raise any particular issues for those institutions. In

³³ For those institutions, the own funds requirement for CVA risks could be set equal to the own funds requirement for Counterparty Credit risk for the same transactions.

case the EBA identifies any issues, it is invited to recommend possible ways to address them.

4.8. Recognition of credit derivative indices as eligible CVA hedges

The EBA should assess, at least qualitatively, the appropriateness of the recognition of credit indices as eligible CVA hedges under the revised CVA framework, in particular whether this treatment could create a disincentive for institutions to use those instruments to hedge their CVA risk. In case the EBA identifies any issues, it is invited to recommend possible ways to address them.

5. Operational risk framework

5.1. General information

The report should provide an overview of the current application of the own funds requirement for operational risk in the EU, including:

- (i) an overview of the use of the current approaches for calculating the own funds requirement for operational risk, including the percentage of institutions using each approach, the share of EU banking assets represented by those institutions, the share of the total own funds requirements for operational risk represented by those institutions;
- (ii) an overview of the main drivers of the own funds requirements for operational risk across different existing approaches. For institutions using the AMA approach, the contribution of the following drivers of reduction of required own funds should be provided: correlations, insurance and other risk transfer mechanisms (ORTM), and expected losses. Where warranted and feasible, variability between institutions using the same approach should be highlighted;
- (iii) an overview of the size and composition of the main sources of operational risk losses. Moreover, the report should also include a comparison of the aggregate operational annual losses (per date of accounting or date of discovery) with the own funds requirements for the same year, or for the series of years corresponding to the timeline of the losses. It should be highlighted whether and by what measure different current approaches have over- or underestimated actual operational risk losses for institutions in the sample (instances where losses exceeded own funds requirements);
- (iv) an overview of the regulatory add-ons for operational risk;

5.2. Capital impact

The report should provide an estimate of the impact of introducing the revised operational risk framework in the EU, separately for each of the approaches currently available under the CRR.

5.3. Implementation/operational/administrative impact

The report should provide a broad assessment of the implementation, operational and administrative costs/benefits for EU institutions related to implementation of the revised operational risk framework for each of the approaches currently available under the CRR. In this assessment, the report should distinguish between one-off and recurring costs/benefits.

5.4. Application of supervisory discretions/permissions

The EBA should provide an assessment of the main challenges of applying the supervisory discretions/permissions allowed under the Basel accord and listed below. The EBA should also provide a cost/benefit analysis of implementing such discretions in comparison with a scenario under which the discretions/permissions are not applied. The supervisory discretions/permissions to be assessed include the following:

- (i) the permission given to institutions to include the loss data for institutions with the Business Indicator Component (BIC) lower than € 1 billion;
- (ii) the decision to set the Internal Loss Multiplier (ILM) equal to 1 for all institutions, in which case own funds requirements would be based solely on the BIC³⁴;
- (iii) the decision to increase the loss data collection threshold to €100,000 for institutions with a BIC greater than or equal to € 1 billion³⁵;
- (iv) the permission given to an institution to use less than five years of losses if the ILM is greater than 1 when supervisors believe the losses are representative of the institution's operational risk exposure³⁶;
- (v) how the materiality thresholds could be set to permit the exclusion of certain operational loss events no longer relevant to the institution's organisational risk profile from the loss component³⁷;

In making this assessment, the EBA should include information on the following:

- (i) a comparative analysis of the loss data and business indicators, including the ratio between LC and BIC for all the institutions in the sample and separately for:
 - institutions in the sample with $BI \leq \text{€}1 \text{ billion}$;
 - institutions in the sample with $\text{€}1 \text{ billion} < BI \leq \text{€}30 \text{ billion}$;
 - institutions in the sample with $BI > \text{€}30 \text{ billion}$;
- (ii) data to set conditions for loss exclusions such as:
 - the nature and impact of the largest one-off losses (outliers);
 - the share and individual size (as % of the institution's average losses) of the loss events that could potentially be subject to exclusion;
 - the impact of retaining the loss events that could potentially be subject to exclusions on the own funds requirement calculated under SA-OR.

³⁴ See paragraph 12 of the revised operational risk framework (BCBS/2017/D424).

³⁵ See paragraph 19(d) of the revised operational risk framework (BCBS/2017/D424).

³⁶ See paragraph 10 of the revised operational risk framework (BCBS/2017/D424).

³⁷ See paragraphs 27 to 29 of the revised operational risk framework (BCBS/2017/D424).

5.5. Additional assessment

The report should provide a qualitative assessment of the possibility to introduce new, or keep, modify or supplement existing provisions in the CRR and the CRD regarding other aspects of the operational risk framework, not directly covered by the new Basel approach. In particular, the analysis should consider the following:

- (i) specific requirements to cope with legal, IT, cyber security and other risks;
- (ii) the governance and organisational qualitative requirements for the purpose of sections 5³⁸ and 6³⁹ concerning the loss database of the revised operational risk framework, including the use of insurance and other techniques for mitigating operational risk;
- (iii) existing requirements within AMA which incentivise more granular measurement of operational risk (e.g., analysis of operational risk per business line or across products and services as opposed to firm-wide), and requirements that incentivise forward looking assessment of risk (e.g., analysis of business environment and internal control factors, scenario analyses, external loss data);
- (iv) where applicable, the role of requirements enumerated in point (iii) and the role of the ICAAP process in strategic decisions on allocation of own funds to cover operational risk across individual group entities and in informing the decisions on Pillar 2 regulatory add-ons for operational risk.

6. Output floor

6.1. Capital impact

The report should provide an estimate of the impact of introducing the output floor as part of the implementation of the other Basel III reforms in the EU. The overall impact of the output floor should be measured relative to the final Basel III reforms absent the output floor requirement.

In addition, the report should provide an analysis of the marginal impact of the output floor on the own fund requirements separately for (i) market risk; (ii) credit risk (including, to the extent possible, a break-down per exposure class); and (iii) counterparty credit risk. In making this analysis, the EBA report should at least provide an estimate of the marginal impact of the output floor for each of those risks and, where applicable, for each exposure class. The EBA should calculate the marginal impact as the difference between (i) the impact related to the introduction of all the final Basel III reforms, including the output floor (as calculated under the 'General considerations' section) and (ii) the impact related to the introduction of all the final Basel III reforms, including the output floor, but assuming that the institution no longer uses an internal model for this type of risk or exposure (this means that the RWAs of the institution for this type of risk or exposure is calculated using the relevant standardised approach on the two instances under which this RWA appears in the output floor formula).

When assessing the impact, the EBA should have regard to the phase-in period, including the institutions' ability to retain profits and increase own funds during that period. The

³⁸ General criteria on loss data identification, collection and treatment.

³⁹ Specific criteria on loss data identification, collection and treatment.

EBA should also opine on the possibility to apply a transitional cap (and if so, on its calibration) on the increase in RWAs due to the output floor during that period.

In light of the above analysis, the EBA should opine on i) whether particular types of risk, exposure classes or business models would be excessively impacted by the introduction of the output floor and ii) whether and to what extent the capital allocation between business lines/exposure classes would be impacted.

Finally, the EBA should assess if and to what extent differences in the treatment of provisions between the SA-CR and the IRBAs for credit risk could have an impact on the output floor calculation.

6.2. Implementation/operational/administrative impact

The report should provide a broad assessment of the implementation, operational and administrative costs/benefits for institutions to implement the output floor proposed by the Basel standards. In this assessment, the report should distinguish between one-off and recurring costs/benefits.

6.3. Assessment of the output floor and the leverage ratio as backstops against RWA variability

The report should provide an overview of institutions for which either (i) the output floor or (ii) the leverage ratio or (iii) neither of them would represent the constraining own funds requirement under the revised framework. For each of these groups, the report should contain information on the number of institutions therein, the nature and proportion of internal models used by those institutions, their share of total EU banking assets, the own funds shortfalls under the constraining own funds requirement and own funds shortfall under any binding own funds requirements.

The report should provide an assessment of the RWA variability of the internal models used by institutions for which either the output floor or the leverage ratio would represent the constraining own funds requirement under the revised Basel III framework and, where possible, some insight on the reasons of potential differences in the RWA variability between the two groups. In making this analysis, the EBA report should provide a quantitative comparison of the RWA variability of the internal models used by institutions between the two groups. This quantitative comparison should at least consider two dimensions: (i) the level of risks of the institutions in each group; (ii) the differences between the own funds requirements calculated under the internal model and the standardised approach for a given type of risk or exposure of the institutions in each group. The EBA is invited to analyse to which extent this variability can be considered unjustified.

6.4. Relationship with other own funds requirements

The report should provide a qualitative assessment of the relationship between the output floor and the other own funds requirements (e.g. Pillar 2, capital buffers). In particular, the EBA should point out whether the introduction of the output floor would result in a potential double-counting of risks with other own funds requirements or any other unintended consequences.

7. Market risk framework

7.1. General information

The report should provide an estimate of the accounting value of the institutions' assets and liabilities subject to own funds requirements for market risk and the corresponding own funds requirements for market risk currently applicable under the CRR.

7.2. Capital impact

The report should provide an estimate of the impact of introducing the final FRTB international standards in the EU (i.e. taking into account any amendments to the FRTB standards that would have been adopted by the BCBS before the date by which the EBA should deliver its report). The estimates should make a distinction between institutions currently using the standardised approach and those using the internal model approach under the CRR and should be broken down with respect to the different components of the own funds requirements under the FRTB for each approach.

The report should also provide a qualitative assessment of the final FRTB international standards in comparison to the FRTB standards agreed by the BCBS in 2016. In particular, the EBA should consider whether the final calibration of the FRTB is suitable for covered bonds issued in the EU.

Finally, the report should provide an estimate of the impact of a potential re-calibration of the Basel II standardised approach for market risk, to the extent such re-calibration would be adopted by the BCBS. Given that this approach would act as a simplified standardised approach under the proposed EU Banking Package, the estimate should be provided for the institutions that would be eligible to use this approach under the proposal.

7.3. Implementation/operational/administrative impact

The report should provide a broad assessment of the implementation, operational and administrative costs/benefits for institutions currently subject to the market risk framework under CRR to adapt to the FRTB under the final Basel standards. In this assessment, the report should distinguish between one-off and recurring costs/benefits.

Data collection

The EBA is requested to collect all data and information that it deems necessary in order to answer the call and substantiate its advice with sufficient evidence. The information should be collected from a sample of institutions of different size, location and business model (as specified under "general considerations") and to the extent possible using the regular Basel III monitoring exercise. EBA should strive to collect all relevant information for the purpose of ensuring a comprehensive response to this call for advice, but should in this regard also be mindful on the feasibility and burden of the data request.

Final considerations

The Commission services would appreciate if the EBA could also report on any other issues or inconsistencies that competent authorities in the EU may have already identified in the may have identified in both the current EU rules on credit, operational, market or

CVA risk as well as the revised BCBS standards. Suggestions on how to rectify the identified issues and inconsistencies or on how to clarify the terminology used would in particular be welcome.

The Commission is aware that time and resource constraints may restrict the range of methodologies that the EBA may use to analyse certain aspects of the Call for Advice. Should this be the case, the EBA should highlight these limitations in its final report.

It is recalled that the analysis provided will not prejudge the Commission's final decision. Moreover, in accordance with the established practices of the Commission Expert Group on Banking, Payments and Insurance, the Commission will continue, where appropriate, to consult the experts appointed by the Member States in the preparation of its proposal.

The EBA should deliver the report to the Commission services by 30 June 2019. If the delivery of the analysis required in Sections 4 and 7 would not be possible by that date, the EBA should deliver that analysis by 30 September 2019 at the latest. In that case, the EBA should still deliver a preliminary analysis required by Section 6 and a preliminary analysis of the combined impact of the key revisions in the report submitted by 30 June 2019.