

Public Hearing: Consultation on off-balance sheet items in the Credit Risk SA

EBA Prudential Regulation and Supervisory Policy

Virtual meeting, 22 April 2024



Contents

1 Background: Banking Package EU Implementation

2 Introduction to the mandate

3 Draft RTS

4 Examples

5 Discussion on impact assessment

6 Q&A



01

Background: Banking Package EU Implementation

Banking package

The banking package:

- Includes amendments to the Capital Requirements Regulation ('CRR') and to the Capital Requirements Directive ('CRD')
- Implements the Basel III framework in the EU
- Ensures that EU banks become more resilient to potential future economic shocks
- Contributes to Europe's recovery from the COVID-19 pandemic
- Contributes to the transition to climate neutrality
- Deepens and facilitates access to the EU single market with stronger enforcement tools

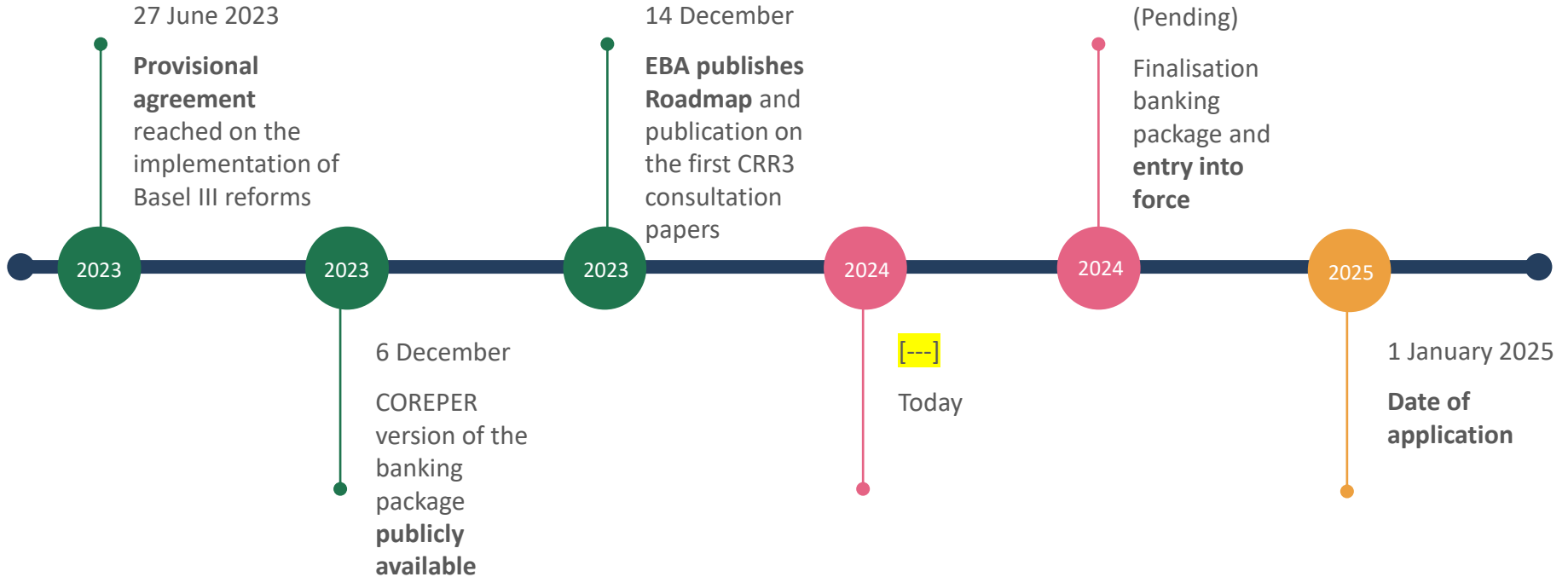
EBA roadmap on strengthening the prudential framework

The EBA roadmap on strengthening the prudential framework was published in December 2023 ([link](#))

Main objectives:

- Providing clarity to the industry on how it will develop the mandates implementing the legislation
- Showing how the EBA expects to finalise the most significant components ahead of the application
- Setting out EBA policy work for the Banking package
- Intended as reference for industry and other stakeholders in their own implementation efforts

Timeline



Principles in designing the EBA roadmap

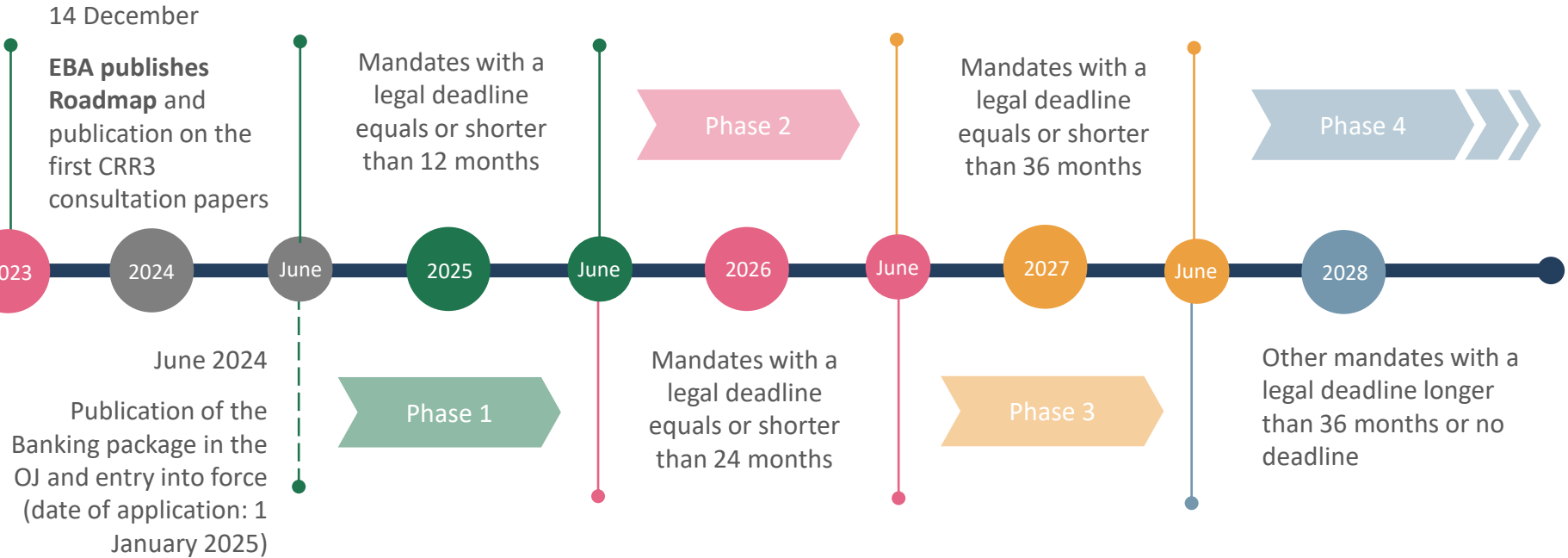
For the design of the EBA roadmap:

- Sequencing of the mandates considering mandates needed for a swift implementation

To reflect operational challenges:

- Envisaged four phases (12 months each, with a longer fourth phase)
- Most mandates to be delivered within two years from entry into force
- Where possible, grouping of mandates to optimise finalisation
- Other ongoing work in parallel, like update of the SREP guidelines

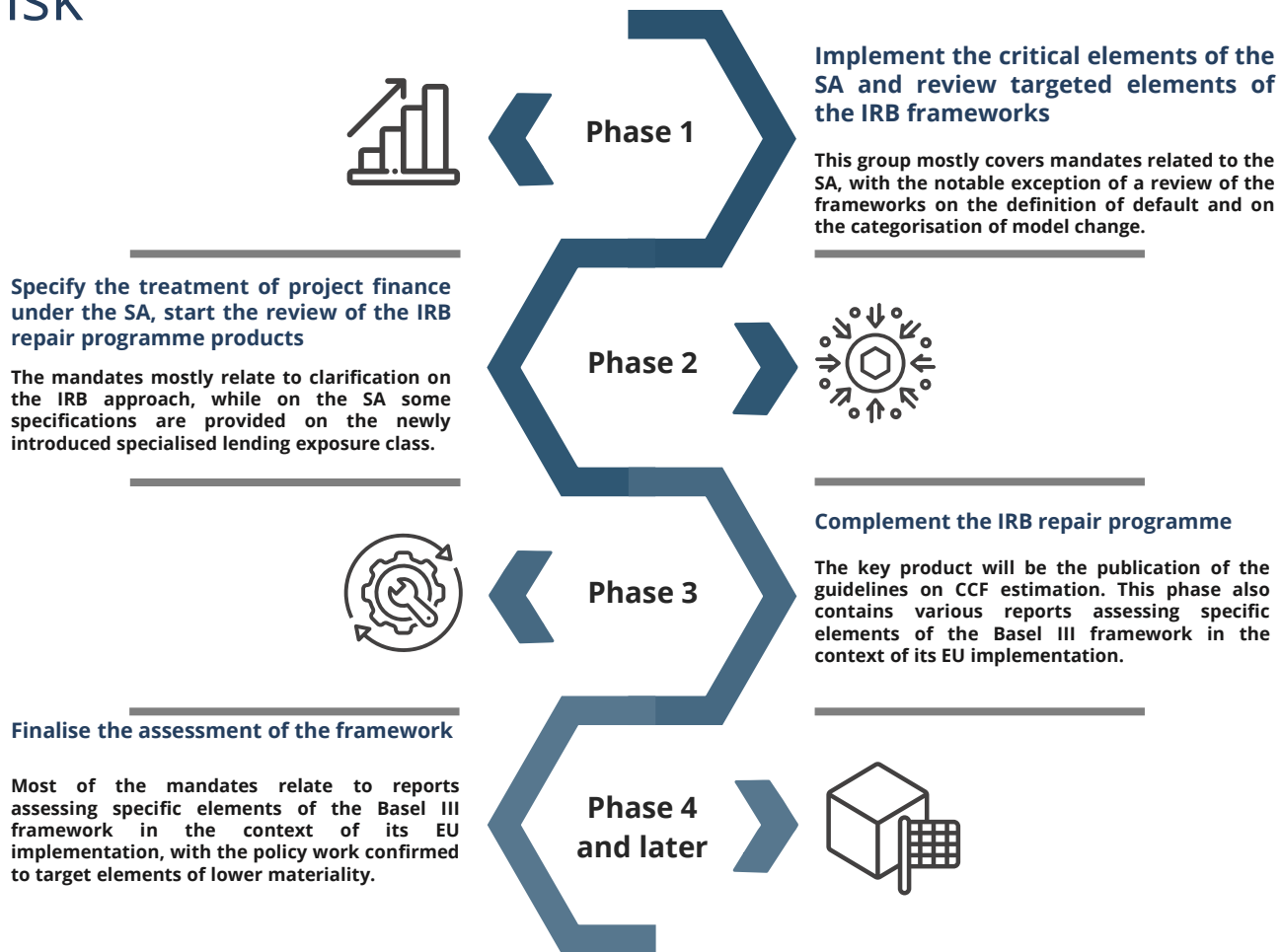
Sequencing in four phases of 12 months each



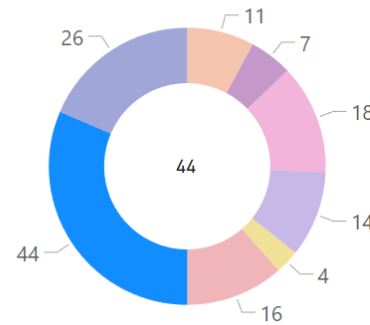
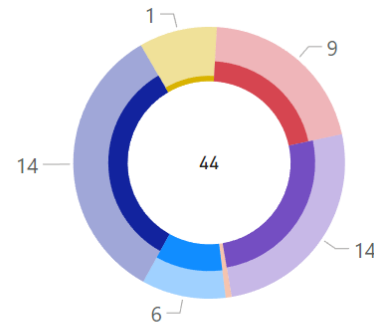
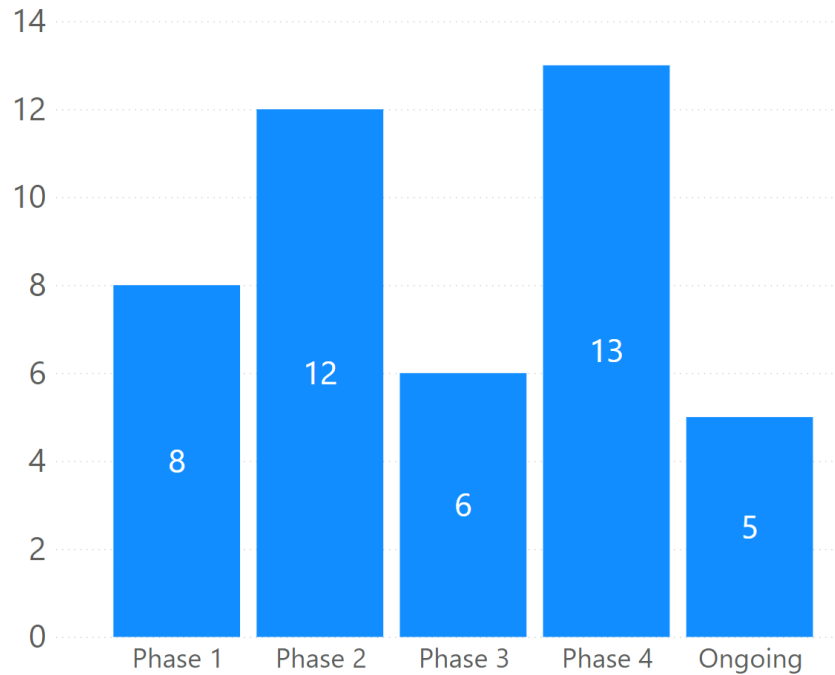
General statistics

- The banking package includes 140 mandates which are necessary to complement the actual practical implementation of the banking package.
- These products consist primarily of:
 - Regulatory and implementing technical standards (60)
 - Guidelines (29)
 - Reports and opinions (37)
- Furthermore, the EBA is tasked with the development of several operational products useful for the level playing field and regulatory disclosure across the EU as well as towards efficiency gains, such as the establishment, the publication and the maintenance of various lists and databases including the EBA Data Hub (14).

Credit risk



Credit risk



GroupProduct

- RTS
- ITS
- Guidelines
- Report
- Opinions and advices
- Others

Area

- Credit Risk
- Market Risk
- Operational Risk
- Governance
- Market access
- Reporting and disclosure
- ESG
- Other



02

Introduction to the mandate

Introduction: Mandate under CRR3 Article 111(8)

The EBA is mandated to develop draft Regulatory Technical Standards (RTS) that specify:

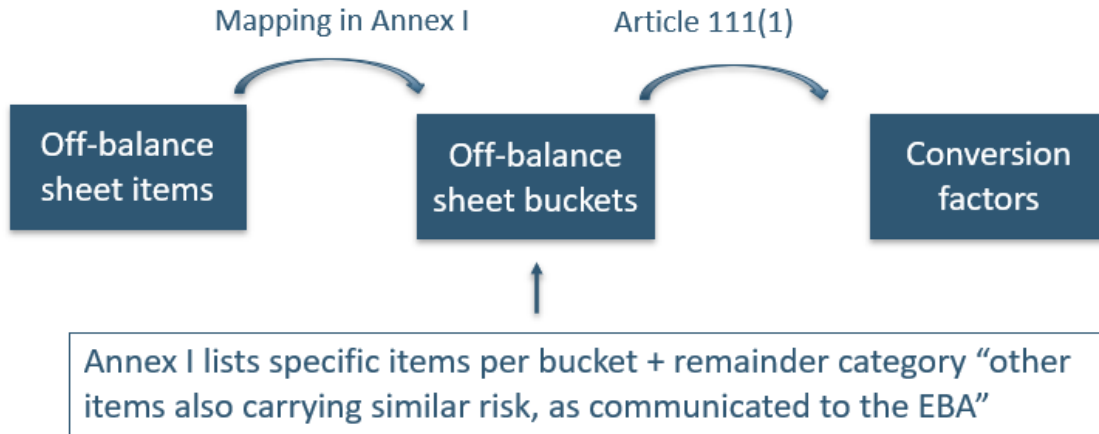
- a) the criteria that institutions shall use to assign off-balance sheet items, with the exception of items already included in Annex I, to the buckets 1 to 5 referred to in Annex I;
- b) the factors that may constrain the institutions' ability to cancel the unconditionally cancellable commitments referred to in Annex I;
- c) the process for notifying EBA about the institutions' classification of other off-balance sheet items carrying similar risks as those referred to in Annex I.

Consultation Period open until 4 June 2024

[Consultation on Regulatory Technical Standards on the allocation of off-balance sheet items and UCC considerations | European Banking Authority \(europa.eu\)](#)

Introduction: Background on off-balance sheet items under CR-SA

Determination of the exposure value of an off-balance sheet item



Introduction: Background on BIII amendments

Changes brought by Basel III on off-balance sheet items under CR-SA:

- Updated calibration percentages: 10%, 20%, 40%, 50% or 100%
- Enhanced granularity buckets
- Definition of:
 - Commitment
 - Unconditionally Cancellable Commitments

Introduction: Mapping criteria set out in Annex I

Mandate CRR3 Art 111(8)(a): Specify “the criteria that institutions shall use to assign off-balance sheet items, with the exception of items already included in Annex I, to the buckets 1 to 5 referred to in Annex I”.

Classification of Off-Balance Sheet Items

Bucket	Items
1	<p>— Credit derivatives and general guarantees of indebtedness, including standby letters of credit serving as financial guarantees for loans and securities, and acceptances, including endorsements with the character of acceptances, as well as any other direct credit substitutes;</p> <p>— Sale and repurchase agreements and asset sales with recourse where the credit risk remains with the institution;</p> <p>— Securities lent by the institution or securities posted by the institution as collateral, including instances where these arise out of repo-style transactions;</p> <p>— Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown;</p> <p>— Off-balance sheet items constituting a credit substitute where not explicitly included in any other category.</p> <p>— <u>Other off-balance sheet items carrying similar risk and as communicated to EBA.</u></p>
2	<p>— Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility;</p> <p>— Performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions and similar transaction-related contingent items, excluding trade finance off-balance sheet items referred to in bucket 4;</p> <p>— <u>Other off-balance sheet items carrying similar risk, as communicated to EBA.</u></p>
3	<p>— <i>Commitments, regardless of the maturity of the underlying facility, unless they fall under another category;</i></p> <p>— <u>Other off-balance sheet items carrying similar risk, as communicated to EBA.</u></p>
4	<p>— Trade finance off-balance sheet items:</p> <ul style="list-style-type: none"> - warranties, including tender and performance bonds and associated advance payment and retention guarantees, and guarantees not having the character of credit substitutes; - irrevocable standby letters of credit not having the character of credit substitutes; - Short-term, self-liquidating trade letters of credit arising from the movement of goods, in particular documentary credits collateralised by the underlying shipment, in case of an issuing institution or a confirming institution; <p>— <u>Other off-balance sheet items carrying similar risk, as communicated to EBA</u></p>
5	<p>— Unconditionally cancellable commitments;</p> <p>— The <i>undrawn amount of retail credit lines for which the terms permit the institution to cancel them to the full extent allowable under consumer protection and related legislation;</i></p> <p>— <i>Undrawn credit facilities for tender and performance guarantees which may be cancelled unconditionally at any time without prior notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower’s creditworthiness;</i></p> <p>— <u>Other off-balance sheet items carrying similar risk, as communicated to EBA.</u></p>

Draft RTS – point (a): Rationale mapping criteria

- Interaction with Annex I allocation criteria
- Notion of conditionality when interpreting percentages:
Example: guarantee (100%)
 - Likelihood on-BS = $f(\text{PD guarantees exposure}) \leftarrow$ may be low
 - Likelihood guaranteed triggered if obligor defaults \leftarrow is likely to be high
- Decision on bucket allocation:
 - Hierarchy based on degree of conditional events that trigger on-BS conversion
 - The higher the number, the lower the percentages:
 - Guarantee: conditionality only default obligor: 100%
 - Performance bond: conditionality default obligor + ability meet contractual obligation: 20%

Draft RTS – point (a): Mapping criteria in RTS (I)

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

2. Off-balance sheet items not already included in Annex I to Regulation (EU) No 575/2013 shall be assigned to the bucket 2 referred to in that Annex where the institution's exposure to the risk of credit losses in the event of default of the obligor is contingent to at least one non-credit risk related event that has yet to occur. Where all the non-credit risk related events have occurred, the item shall be assigned to the bucket 1. Drawing from a commitment shall not be considered as a non-credit risk related event for these purposes.

Draft RTS – point (a): Mapping criteria in RTS (II)

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

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

Open questions

- Do you have any comment on the allocation criteria proposed under Article 1?
 - Do you have any suggestion regarding allocation criteria for buckets 4 and 5?
-

Examples not provided in the legal text

- Non-exhaustive list of additional off-balance sheet items
- Provide clarity and prevent risk mis-allocation
- Specific question on commitments not yet accepted by client, where certain amount must be drawn:
 - Beyond strict remit but to improve value-added for stakeholders
 - **Open questions:**
 - Which is the average period of time for a client to accept a mortgage loan offer?
 - What is the applicable percentage that institutions currently apply to these commitments?
 - What is the average acceptance rate by the client of a mortgage loan offered by the bank?

Draft RTS – point (b): Factors constraining UCC

The following factors may constrain the institutions' ability to cancel the unconditionally cancellable commitments referred to in point (b) of Article 111(8) of Regulation (EU) No 575/2013:

- a) Deficiencies in the risk management procedures, including shortcomings in the credit risk monitoring framework and in the IT systems and processes.
- b) Commercial considerations aimed at avoiding negative impacts on the creditworthiness of the clients or on the business relationship with the clients.
- c) Reputational risks, whereby commitments are not being cancelled by the institutions with a view to avoid creating a potential negative perception vis-a-vis market-participants.
- d) Litigation risks

Draft RTS – point (c): Notification process

The institutions' classification of other off-balance sheet items carrying similar risks as those referred to in Annex I to Regulation (EU) No 575/2013 shall be reported in accordance with Implementing Regulation (EU) 2021/451.

Do you have any comment on the notification process?

Impact assessment

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

Tentative timeline

Date	Process
4 June 2024	Closure Consultation Period
2024 Q3	Processing feedback, producing final report
2024 Q4	Internal bodies approval Final Report publication and transmission to Commission

Thank you!



Floor 24-27, Tour Europlaza
20 Avenue André Prothin
92400 Courbevoie, France

Tel: +33 1 86 52 70 00
E-mail: info@eba.europa.eu

<https://eba.europa.eu/>