Single Rulebook Q&A

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Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Own funds
Article	473a, 468
Paragraph	-
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	n.a.
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Disclose name of institution / entity	Yes
Name of institution / submitter	ECB
Country of incorporation / residence	Germany
Type of submitter	Competent authority
Subject matter	Prudential filter on unrealised gains and losses on governmental exposures and interaction with the IFRS 9 transitional arrangements
Question	What amount of unrealised gains/losses under the "a" of Article 468 needs to be considered to be filtered by factor f for a sovereign exposure measured at FVOCI?
Background on the question	In IFRS 9 Example 13 the recording of provisions in IFRS 9 for FVOCI is explained.In example 13, it is explained that an asset with a value of 1000 has suffered from a fair value reduction of 50. The bank also records 30 ECL (impairment). The following journal entries are made from an accounting perspective: DebitCreditImpairment loss (profit or loss)CU30 Other comprehensive income (a)CU20 Financial asset—FVOCI CU50(To recognise 12-month expected credit losses and other fair value changes on the debt instrument)(a)The cumulative loss in other comprehensive income at the reporting date was CU20. That amount consists of the total fair value change

of CU50 (ie CU1,000 – CU950) offset by the change in the accumulated impairment amount representing 12-month expected credit losses that was recognised (CU30).For the purposes of illustrating the impacts of possible views in interpreting Article 468 and Article 473a CRR we assume the following case (tax effects are ignored):- the instrument is a 10 year maturity government bond which has been bought on 1.1.2020 at a price of 1000 euro and is classified in the FVOCI portfolios;- the bank applies the standardised approach to determine capital requirements for credit risk; - the fair value decreases to 950 euro at the end of 2020 and remains stable for the next 5 years;- the bank records ECL for 30 euro at the end of 2020. No changes in the ECL amount in the next five years.- The bank has opted to remove the unrealised gains/losses on government exposures measured at FVOCI (art. 468 CRR) and apply the full IFRS 9 transitional arrangements (art. 473a)As regards the interpretation of Article 468 (in interaction with 473a) there are two possible interpretations on the amount of unrealised gains and losses that can be removed from CET1:View AThe amount of unrealised losses (α) according to Article 468 is 50 (i.e. the full fair value reduction). This amount will be then multiplied by the following factors: 1 for 2020; 0.7 for 2021; 0.4 for 2022. The resulting amount is then removed from CET1. For the period 2020-2022 the 30 being recorded as impairment is not eligible for the calculation of the amount to be added back to CET 1 under Article 473a. During 2023 and 2024 the ECL amount of 30 is considered in the calculation of the “dynamic” add-back according to paragraph 4 of article 473a with the following factors: 0.5 for 2023 and 0.25 for 2024. This view interprets “unrealised” as any loss that does not yet meet the criteria for write-offs (fully or partially) or for de-recognition, thus this concept also includes “expected credit losses” under the impairment framework.View B1The amount of unrealised losses (α) according to Article 468 is 20 (i.e. the accumulated amount recorded in OCI). This amount will be then multiplied by the following factors: 1 for 2020; 0.7 for 2021; 0.4 for 2022. The resulting amount is then removed from CET1. For the period 2020-2022 the 30 being recorded as impairment is not eligible for the calculation of the amount to be added back to CET 1 under Article 473a. During 2023 and 2024 the ECL amount of 30 is considered in the calculation of the “dynamic” add-back according to paragraph 4 of article 473a with the following factors: 0.5 for 2023 and 0.25 for 2024.Article 468 describes “a” as: “the amount of unrealised gains and losses accumulated since 31 December 2019 accounted in “fair value changes of debt instruments measured at fair value through other comprehensive income” of the balance sheet […]”. Therefore, a possible interpretation is that the amount to be filtered corresponds to “The cumulative loss in other comprehensive income at the reporting date” as described in IFRS 9.IE13 (20 in the example). In addition, neither CRR nor IFRS 9 define the concept of “unrealised”. A possible interpretation of this concept is that it did not include expected credit losses that are booked in P&L. Under this view the provision in article 473a “where subject to Article 468, excluding expected credit losses determined for exposures measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of the Annex relating to IFRS 9” is interpreted with the meaning that if an exposure is subject to the application of Article 468, the related ECL are excluded from the calculation of the “dynamic” add-back according to Article 473a.View B2The amount of unrealised losses (α) according to Article 468 is 20 (i.e. the accumulated amount recorded in OCI). This amount will be then multiplied by the following factors: 1 for 2020; 0.7 for 2021; 0.4 for 2022. The resulting amount is then removed from CET1. For the period 2020-2024 the 30 being recorded as impairment is eligible for the calculation of the amount to be added back to CET 1 under Article 473a with the following factors: 1 for 2020 and 2021, 0.75 for 2022, 0.5 for 2023 and 0.25 for 2024.The rationale of this view is the same as under view B1 with regards to the application of article 468. However, differently from view B1, under this view the provision in article 473a “where subject to Article 468, excluding expected credit losses determined for exposures measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of the Annex relating to IFRS 9” is interpreted with the meaning that if expected credit losses are removed from CET1 due to the application of Article 468, they are excluded from the calculation of the “dynamic” add-back according to Article 473a.* * *The table below summarises the CET1 impact of the three different views during 5 year time horizon. As the filter on unrealised gains and losses according to article 468 expires on 31 December 2022, after that date, under all the views, the only CET1 benefit is the one provided by Article 473a that expires on 31 December 2024. During the period 1 January 2020 – 31 December 2022 View A would be less beneficial for banks than View B2, since under View A the amount of ECL would be subject to the relevant factors in article 468, which are lower than the factors in article 473a. However, under the same time horizon, View A would be more beneficial than View B1, since under View B2 the ECL booked against OCI would not be eligible for the purposes of article 473a   20202021202220232024View AUnrealised losses a (art. 468)€ 50.00€ 50.00€ 50.00€ 50.00€ 50.00Applicable factor for "unrealised losses" (art. 468)10.70.400CET1 impact due to unrealised losses filter (art. 468)€ 50.00€ 35.00€ 20.00€ -€ -"dynamic" amount A4,SA (art. 473a)€ -€ -€ -€ 30.00€ 30.00Applicable factor for "dynamic" approach (art. 473a)110.750.50.25CET1 impact due to "dynamic" approach (art. 473a)€ -€ -€ -€ 15.00€ 7.50Total CET1 impact € 50.00€ 35.00€ 20.00€ 15.00€ 7.50View B1Unrealised losses a (art. 468)€ 20.00€ 20.00€ 20.00€ 20.00€ 20.00Applicable factor for "unrealised losses" (art. 468)10.70.400CET1 impact due to unrealised losses filter (art. 468)€ 20.00€ 14.00€ 8.00€ -€ -"dynamic" amount A4,SA (art. 473a)€ -€ -€ -€ 30.00€ 30.00Applicable factor for "dynamic" approach (art. 473a)110.750.50.25CET1 impact due to "dynamic" approach (art. 473a)€ -€ -€ -€ 15.00€ 7.50Total CET1 impact € 20.00€ 14.00€ 8.00€ 15.00€ 7.50View B2Unrealised losses a (art. 468)€ 20.00€ 20.00€ 20.00€ 20.00€ 20.00Applicable factor for "unrealised losses" (art. 468)10.70.400CET1 impact due to unrealised losses filter (art. 468)€

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EBA answer	In accordance with paragraph 4 (b) of Article 468 of Regulation (EU) No 575/2013 (CRR), where an institution removes an amount of unrealised losses from its Common Equity Tier 1 items, it shall recalculate all requirements laid down in this Regulation that are calculated using the amount of specific credit risk adjustments. It is also specified in paragraph 4 that, when recalculating the relevant requirement, the institution shall not take into account the effects that the expected credit loss provisions relating to exposures to central governments, to regional governments or to local authorities referred to in Article 115(2) of this Regulation and to public sector entities referred to in Article 116(4) of this Regulation, excluding those financial assets that are credit-impaired as defined in Appendix A to the Annex relating to IFRS 9, have on those items. Additionally, in paragraphs 3 and 5 of Article 473a CRR, the following reference was added "a*nd, where Article 468 of this Regulation applies, excluding expected credit losses determined for exposures measured at fair value through other comprehensive income*". In practice, this means that the amount of expected credit losses for these exposures should be excluded from the calculations performed under these two paragraphs. Combining the above references included in the two relevant Articles of the CRR, it seems clear that the amount of expected credit losses relating to exposures to central governments, to regional governments or to local authorities and to public sector entities (30, in the example) is to be excluded from the treatment under Article 473a during the period under which Article 468 is in place (1 January 2020 to 31 December 2022 - the 'period of temporary treatment'). At the same time, the full fair value change (an unrealised loss of 50, in the example) should be treated under Article 468 CRR. As such, view A as presented by the submitter should be applied.
Link	https://www.eba.europa.eu/single-rule-book-qa/qna/view/publicId/2020_5346