

# Single Rulebook Q&A

<b>Question ID</b>	2018_4390
<b>Status</b>	Final Q&A
<b>Legal act</b>	Regulation (EU) No 575/2013 (CRR)
<b>Topic</b>	Credit risk
<b>Article</b>	150
<b>Paragraph</b>	2
<b>Subparagraph</b>	-
<b>COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations</b>	Not applicable
<b>Article/Paragraph</b>	na
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<b>Disclose name of institution / entity</b>	No
<b>Type of submitter</b>	Competent authority
<b>Subject matter</b>	Calculation method for materiality ratio to be compared against the 10%/5% threshold for the purpose of application of Article 150(1)(c) for equity exposure class (Permanent Partial Use)
<b>Question</b>	<p>How should a credit institution - with the prior permission to apply the standardised approach permanent partial use (PPU) ex Article 150 CRR for equity exposures - calculate the threshold as per Article 150(2) CRR?</p> <p>How is the materiality ratio computed? In particular:</p> <ol style="list-style-type: none"> <li>Should the numerator include only the exposures for which the application for PPU is being sought under Article 150(1)(c) CRR by excluding exposures for which PPU has already been granted pursuant other points of Article 150(1) and exposures not to be included in the calculation of RWA for equity exposure pursuant to Article 155(1) (i.e. Equity exposures risk weighted at 250% in accordance with Article 48(4) of Reg. EU 575/2013 and those deducted from CET1 in accordance with Part Two of Reg. EU 575/2013)?</li> <li>Should the ratio be computed only at solo level or both at solo and consolidated level, in case an application is limited to only one Legal</li> </ol>

	Entity (LE) of a Large Group?
<b>Background on the question</b>	<p>Article 150 of Regulation (EU) No 575/2013 (CRR) provides the requirement to include a certain exposure class in the PPU perimeter, by assessing the relative materiality (generally only exposures deemed as immaterial can be included in the PPU perimeter). It appears that the evaluation is aimed to assess the respect of the threshold for an institution that currently uses the IRB and intends to require the permission to use the standardised (SA) approach. Regarding the equity exposure class, Article 150(2) CRR states that "the equity exposure class of an institution shall be material if their aggregate value, excluding equity exposures incurred under legislative programmes as referred to in point (h) of paragraph 1, does not exceed on average over the preceding year 10 % of the own funds of the institution. Where the number of those equity exposures is less than 10 individual holdings, that threshold shall be 5 % of the own funds of the institution." However in point (1)(g) of Article 150 it is stated that "equity exposures to entities whose credit obligations are assigned a 0 % risk weight under Chapter 2 including those publicly sponsored entities where a 0 % risk weight can be applied" can be included in the PPU perimeter, without any other requirement to be fulfilled. In other words, Article 150(2) provides indications whether an equity exposure class of an institution shall be considered material, in the context of Article 150(1), introduced within subparagraph 150(1)(c), but it does not specify whether exposures, for which PPU has already been granted pursuant to criteria different from the materiality one as per Article 150(1)(c) can be excluded from the calculation of the materiality ratio. Consequently, potential double counting can arise in the evaluation of the potential PPU perimeter. Furthermore, Article 150(2) does not specify whether equity exposures not subject to RWA calculation according to Article 155 CRR (risk weighted at 250% and those deducted from CET1 in accordance with Part Two of CRR) should be excluded from the computation. It follows that it is not clear how a credit institution with the prior permission to apply the SA (in PPU ex Article 150 CRR) for equity exposures should calculate the 10% threshold as per Article 150(2) CRR and in particular: Whether the amount of equity exposures in the numerator of the ratio should include all the equity exposures (also the ones deducted ex Articles 36 and 48 CRR and the ones at 250%RW ex Article 48(4)); Whether 4 instead of 5 quarters should be considered in order to determine the average for calculating the denominator (i.e. own funds) of the ratio; Whether the participation in the capital of a central bank should be included in the numerator of the ratio; Whether in case the equity holdings are above the 10% threshold the institution has to use the AIRB RW (ex Article 155 CRR; not using anymore the SA ex Article 133 CRR) starting from the same quarter of the breach (i.e. no possibility to implement a sort of "plan" to return to compliance to remain within the Article 133). In this regard, we can imagine an example where a bank breaches the 10% threshold in 1Q2019 and in the 2Q2019 the bank manages to fix it returning within the 10% limit: it is not clear whether the bank will apply the AIRB RW for 1Q</p>

and again the SA RW for the 2Q or whether there is a sort of "minimum period" of application of the AIRB RW or once breached the 10% threshold the bank will lose forever the possibility to apply the Article 133.

**EBA answer**

Article 150 of Regulation (EU) No 575/2013 (CRR) as amended specifies the conditions an institution must fulfill to ask the competent authority (CA) for permission to apply the permanent partial use (PPU) to certain exposures. Article 150(1)(c) CRR indicates that PPU can apply to "exposure classes or types of exposures which are immaterial in terms of size and risk profile". Article 150 (2) CRR details the level of materiality to be taken into account for equity exposures when asking for permission to apply the PPU: "the equity exposure class of an institution shall be material if their aggregate value, excluding equity exposures incurred under legislative programs as referred to in point (h) of paragraph 1, exceeds on average over the preceding year 10 % of the own funds of the institution" except when the number of equity exposures is less than 10 individual holdings, in which case the aforementioned threshold is set at 5%.

According to Article 150(1)(h)CRR, all exposures belonging to the equity exposure class should be included in the numerator of the materiality threshold, except equity exposures incurred under legislative programs but "up to a limit of 10 % of own funds". It includes therefore all other types of equity holdings, which are subject to risk weighting, with the exception of exposures not deducted from the capital but risk weighted at 250% in accordance with Article 48(4) of the CRR or at 370% in accordance with Article 471 of the CRR.

Regarding the denominator of the materiality threshold, own funds are to be computed as stated in CRR Part II of the CRR. "The average over the preceding year" mentioned in Article 150(2) should be determined as the average of the 4 last quarters (this includes the quarter that ends at the respective reporting date for in relation to which the calculation is done), in order to restrict the effects of the volatility per quarter.

As specified in 150(1) CRR, PPU can only be applied if an institution has received prior permission by CA. For the exposures described in 150(1)(c), the CA may authorise the use of PPU for exposures that meet the "immateriality of exposures" criterion, which for the equity exposure class is based on an average over the preceding year, as set out in Article 150 (2). The CRR does not provide for the application of a phase-in period, when the threshold is reached. Therefore, if the equity holdings are above the 10% or the 5% threshold, as applicable, the institution shall use the IRB Approach for the equity exposure class laid down in point (e) of Article 147(2).

For the purposes of the capital requirements on a consolidated level, the materiality ratio has to be calculated on such consolidated level. Where one

	or more subsidiaries have the permission to apply the IRB Approach, the ratio also has to be computed on the solo level of the subsidiary or subsidiaries.
<b>Link</b>	<a href="https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_4390">https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_4390</a>

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