Single Rulebook Q&A

Question ID	2018_4410
Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit risk
Article	162
Paragraph	2
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	-
Date of submission	07/12/2018
Published as Final Q&A	21/05/2021
Disclose name of institution / entity	No
Type of submitter	Credit institution
Subject matter	Maturity of instruments subject to a cash flow schedule
Question	Should an institution that has received the permission of the competent authority to use own LGDs for exposures to corporates, apply the formula in Article 162(2)(a) CRR, for both fixed interest rate and variable interest rate loans, where no change of the cash flow timing is applicable?
Background on the question	Article 162(2)(a) CRR requires the application of the formula reported in said Article for determining the maturity (M) of instruments subject to a cash flow schedule.The Article makes no reference to the fact that cash flows are calculated by applying a fixed or a variable interest rate. However, it seems clear that if the final maturity and the schedule of the payments is determined - even in the presence of variations of the amount of single cash flows due to changes in variable interest rates - the formula is to be applied, whereas M shall be the maximum remaining time (in years) that the obligor is permitted to take to fully discharge its contractual obligations only for instruments, for which an institution is not in a position to calculate M as set out in Article 162(2)(a) CRR. For instruments with variable interest rate but predetermined cash flow schedule, institutions are in fact in a position to calculate M (e.g. by applying forward rates for determining future cash flows). On the other hand, the application of a longer maturity for a floating

	interest rate loan, having exactly the same principal amortization plan as a fixed interest rate loan, would be counterintuitive.
EBA answer	Institutions that have received the permission of the competent authority to use own estimates of LGDs and own conversion factors for exposures to corporates, institutions or central governments and central banks or institutions that have received a permission as referred to in the second subparagraph of Article 162(1) of Regulation (EU) No 575/2013 (CRR) shall specify M in accordance with point (a) of Article 162(2) CRR where an instrument is subject to a cash flow schedule. Article 162(1)(a) CRR does not include any further limitations whether the cash flow schedule is linked to instruments with fixed or variable interest rates are introduced. As a consequence, the formula referred to in Article 162(2)(a) CRR shall be applied for instruments subject to a cash flow plan regardless whether the underlying interest rates are fixed or variable. However, the formula in point (a) of Article 162(2) CRR requires, as an input, for all periods t the cash flows contractually payable by the obligor in period t. Consequently, in order to be in a position to calculate M as set out in point (a) of Article 162(2) CRR, institutions should calculate the amount and timing of these cash flows. In the particular cases of cash flows where the interest rate is based on an index rate, institutions should use the reference rate referenced in the underlying contract at the last reporting date as the applicable reference rate for future periods for the purposes of determining cash flows in accordance with point (a) of Article 162(2) CRR. This clarification only applies to changes in variable interest rates resulting from the fluctuation of a reference rate. Changes in the variable interest rates, resulting from a change in other inputs to the calculation of variable interest rates should however be reflected accordingly in the calculation of future cash flows.
Link	https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_4410