
EBA/CP/2021/03

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Consultation Paper

Draft Guidelines

specifying the criteria to assess the exceptional cases when institutions exceed the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013 and the time and measures to return to compliance pursuant to Article 396(3) of Regulation (EU) No 575/2013

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the ‘send your comments’ button on the consultation page by 17.05.2021. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA’s rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA’s Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

In general, the large exposures framework acts as a backstop, safeguarding an institution from significant losses caused by the sudden default of a client or a group of connected clients due to the occurrence of an unforeseen event which could endanger the institution's solvency.

If in an exceptional case an institution breaches the limits set out in Article 395(1) of the CRR, the first subparagraph of Article 396(1) of the CRR requires to report the value of the exposure with no delay to the competent authority, which may (where the circumstances warrant it) allow the institution a limited period of time in which to restore compliance with the limit.

Article 396(3) of the CRR² mandates the EBA to issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010¹, to specify how competent authorities may determine: (a) the exceptional cases referred to in paragraph 1 of Article 396 of the CRR; (b) the time considered appropriate for returning to compliance; and (c) the measures to be taken to ensure the timely return to compliance of the institution.

The guidelines contain 4 sections: i) Criteria to determine the exceptional cases referred to in Article 396(1) of the CRR; ii) Information to be provided to the competent authority in case of a breach of the LE limits; iii) Criteria to determine the appropriate time to return to compliance with the limits of Article 395(1) of the CRR; and iv) Measures to be taken to ensure the timely return to compliance of the institution with the limits of Article 395(1) of the CRR.

Current practices by competent authorities have constituted the starting point for the development of these guidelines. The guidelines have been developed with the following objectives: (i) provide guidance to competent authorities in their assessment of the breaches of the large exposure limits set in Article 395(1) of the CRR, (ii) ensure a prudent and harmonised application of Article 396(3) of the CRR, while keeping the approach simple and (iii) ensure a level playing field among institutions in the Union.

These guidelines provide guidance from a going-concern perspective. Gone-concern situations in which an institution is in the process of restructuring or undergoes a similar crisis-induced scenario are consequently outside the scope of these guidelines. In such situations, measures are needed that go well beyond restoring compliance with the large exposures framework of the CRR.

Next steps

The guidelines will be translated into the official EU languages and published on the EBA website. The deadline for competent authorities to report whether they comply with the guidelines will be two months after the publication of the translations. The guidelines will apply from 01.03.2022.

¹ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. OJ L 331, 15.12.2010, p. 12–47

3. Background and rationale

General considerations on breaches of the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013

Background

1. In October 2016 the EBA issued an opinion in response to a European Commission's call for advice, where it set out its views on the review of the European large exposures regime.² In that opinion, the EBA called on the EU institutions to introduce some amendments with a view to (a) aligning Regulation (EU) No 575/2013 (the Capital Requirements Regulation, hereinafter the CRR)³ with the Basel standard on large exposures (LEX30)⁴; (b) removing some exemptions and (c) improving some technical details.
2. As part of the Risk Reduction Measures (RRM) package adopted by EU legislators in May 2019, the CRR was amended.⁵ The amended CRR reflected some of the elements of the EBA's opinion. For instance, the capital basis on which large exposure limits are calculated are restricted to Tier 1 capital, and a tighter limit of 15% of Tier 1 capital on exposures between global systemically important institutions (G-SIIs) has been also introduced.⁶ In addition, the CRR has incorporated a mandate for EBA Guidelines to specify the key aspects of the treatment of breaches to large exposure limits, as recommended in the aforementioned opinion.
3. In general, the large exposures framework acts as a backstop, safeguarding an institution from significant losses caused by the sudden default of a client or a group of connected clients due to the occurrence of an unforeseen event which could endanger the institution's solvency.

Legal mandate

4. Article 395(1) of the CRR defines the large exposure limits to a client or a group of connected clients, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403 of the CRR, as 25% of the institution's Tier 1 capital (or 15% between G-SIIs). Furthermore, if the client is an institution or the group of connected clients includes one or more institutions, the limit shall be either 25% of the institution's Tier 1 capital or EUR 150 million, whichever is the higher. According to Article 395(3) of the CRR, institutions shall comply with these large exposure limits at all times.

² The EBA's response to the European Commission's call for advice, EBA-OP-2016-17 of 24 October 2016.

³ Regulation (EU) No 575/2013 of the European Parliament and of the Council, of 26 June 2013, on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

⁴ LEX Large exposures LEX30 Exposure measurement.

⁵ Regulation (EU) No 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012. OJ L 150, 7.6.2019, p. 1–225.

⁶ These changes will enter into force as of 28 June 2021.

5. According to Article 393 of the CRR, institutions shall have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying, managing, monitoring, reporting and recording all large exposures and any subsequent changes to them, in accordance with the CRR.
6. If, in an exceptional case, an institution breaches the limits set out in Article 395(1) of the CRR (hereinafter, the large exposure limits), the first subparagraph of Article 396(1) of the CRR requires the institution to “report the value of the exposure without delay to the competent authority, which may, where the circumstances warrant it, allow the institution a limited period of time in which to comply with the limits.”⁷
7. Regulation (EU) No 2019/876 amending the CRR, published in the Official Journal (OJ) of the EU on 7 June 2019 (hereinafter, the CRR2), includes several mandates relating to the calculation and limitation of large exposures. Among them, a new third subparagraph was added in Article 396(1) of the CRR, stating that *“where, in the exceptional cases referred to in the first and second subparagraph of this paragraph, a competent authority allows an institution to exceed the limit set out in Article 395(1) for a period longer than three months, the institution shall present a plan for a timely return to compliance with that limit to the satisfaction of the competent authority and shall carry out that plan within the period agreed with the competent authority. The competent authority shall monitor the implementation of the plan and shall require a more rapid return to compliance if appropriate”*.
8. Article 396(3) of the CRR2 mandates the EBA to issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010⁸, to specify how competent authorities may determine:
 - a) the exceptional cases referred to in paragraph 1 of Article 396 of the CRR;
 - b) the time considered appropriate for returning to compliance; and
 - c) the measures to be taken to ensure the timely return to compliance of the institution.
9. These guidelines give effect to that mandate. Although the CRR does not establish a deadline to publish the guidelines, the EBA roadmap on the Risk Reduction Measures (RRM) package of November 2019 foresees their publication by 31 December 2021.⁹
10. The cases set out in Article 395(5) of the CRR, i.e. large exposure breaches stemming exclusively from exposures on the institution’s trading book, fall outside the scope of these guidelines as long as the conditions laid down in that provision are fully met.

⁷ The second subparagraph of Art. 396(1) also establishes that “where the amount of EUR 150 million referred to in Article 395(1) is applicable, the competent authorities may allow the 100% limit in terms of the institution’s Tier 1 capital to be exceeded on a case-by-case basis.”

⁸ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. OJ L 331, 15.12.2010, p. 12–47

⁹ The EBA published on 21 November 2019 a roadmap on the Risk Reduction Measures (RRM) package with a planned timetable to deliver the regulatory deliverables according to the mandates given by the CRR2 to the EBA. (<https://eba.europa.eu/eba-publishes-its-roadmap-risk-reduction-measures-package>).

Rationale for the Guidelines

11. The purpose of these guidelines is to provide guiding principles based on pre-defined criteria to help competent authorities to decide whether the exceptional circumstances leading to a breach of the large exposure limits would justify allowing an institution a limited period of time in which to comply with the limit.
12. The guidelines also provide criteria for competent authorities to determine the specific period of time considered appropriate for an institution to return to compliance with the large exposure limits, and the measures to be taken to ensure the timely return to compliance of the institution.
13. These guidelines provide guidance from a going-concern perspective. Gone-concern situations in which an institution is in the process of restructuring or undergoes a similar crisis-induced scenario are consequently outside the scope of these guidelines. In such situations, measures are needed that go well beyond restoring compliance with the large exposures framework of the CRR.
14. Current practices by competent authorities have constituted the starting point for the development of these guidelines. Therefore, the guidelines have been developed with the following objectives:
 - i. Provide guidance to competent authorities in their assessment of the breaches of the large exposure limits set in Article 395(1) of the CRR.
 - ii. Ensure a prudent and harmonised application of Article 396(3) of the CRR, while keeping the approach simple.
 - iii. Ensure a level playing field among institutions in the Union.

Exceptional cases when institutions exceed the large exposure limits and criteria to assess a breach of the large exposure limits

15. Article 395(3) of the CRR establishes that institutions shall comply at all times with the large exposure limits. Furthermore, Article 396(1) of the CRR requires that institutions have to report the value of the exposure without delay to their competent authorities if, in an exceptional case, exposures exceed the large exposure limits. The reading of these two legal provisions together make it clear that all breaches of the limits of Article 395(1) of the CRR (which are not covered by the specific rules on trading book exposures in paragraph 5 of the same Article) are to be considered “exceptional”. Article 396(3)(a) of the CRR requires the EBA to specify the exceptional cases of paragraph 1 of that Article.
16. When an institution exceeds the large exposure limits, the competent authority should investigate the specific circumstances that have led to the breach. Such assessment should always be performed on a case-by-case basis following a holistic approach.
17. In order to assess a breach of the large exposure limits and decide the time, if any, that the institution should be granted to comply with the limits of Article 395(1) of the CRR, as a general rule, the following aspects should at least be considered:

- The breach should be a rare event. The guidelines include some non-binding quantitative criteria that competent authorities could consider when assessing this aspect.
 - Any large exposure breach that an institution applying a proper and effective risk management could have foreseen and thus prevented, should not qualify as an exceptional case.
 - The institution was not in a position to prevent the large exposure breach as it was beyond its control, i.e. the reason for the breach lay outside the institution's control.
18. There might be cases which may seem to qualify as exceptional for the purposes of applying these guidelines but, on a closer look, and considering all the information available to the competent authority, should be treated differently, e.g. as a recurrent breach requiring further supervisory measures.
19. Where a competent authority concludes that the institution should remedy the breach within three months and has informed the institution to that end, the institution does not need to present a formal plan for a timely return to compliance (compliance plan). However, the institution should always discuss and agree with the competent authority a set of measures to restore compliance within a period shorter than three months.

Information that should be provided to the competent authority in case of breach of the large exposure limits, including an institution's preliminary actions to return to compliance with the large exposure limits

20. According to Article 396(1) of the CRR, when an exposure has exceeded the large exposure limits, the institution shall report to its competent authority the value of the exposure.
21. Although not part of the mandate of Article 396(3) of the CRR, it is considered necessary that the guidelines should further specify the content of the report of the breach to put the competent authority in a position to assess the situation and the further steps needed. Therefore, besides the elements of Article 396(1) of the CRR, these guidelines introduce a minimum set of information that the institution in breach should at least provide, namely: a) the name of the client concerned and, where applicable, the name of the group of connected clients concerned; b) the date of the occurrence of the breach; c) its magnitude in relation to Tier 1 capital; d) a description of the available collateral, both CRR eligible and ineligible, if any; e) the reasons for the breach; and f) the remedial actions (planned or already effected) and expected time needed to return to compliance with the large exposure limits.
22. Such information to be included in the report of the breach is without prejudice to the right of competent authorities to request further information and explanations when the information provided by the institution lacks clarity or sufficient detail, or if any additional information is needed.

Criteria to determine the appropriate time to return to compliance with the large exposure limits

23. Article 396(3)(b) of the CRR requires the EBA to specify how competent authorities may determine the time considered appropriate for returning to compliance.
24. Institutions shall have in place adequate internal control mechanisms and sound administrative and accounting procedures to manage their large exposures. This should prevent the occurrence of breaches to the large exposure limits. Therefore, the occurrence of a breach should be considered as an exceptional case and the institution has to resolve the breach as soon as possible.
25. Notwithstanding the above, when an institution reports a breach of the large exposure limits, the competent authority may determine the time considered appropriate for returning to compliance. The guidelines include a number of criteria that should help a competent authority make a decision: a) the institution's record of breaches; b) the promptness of notifying the breach or the remedial actions to return to compliance; c) the reasons, complexity and magnitude of the breach; d) the overall financial situation of the institution; e) the overall risk concentration in the banking book; [f) the type of counterparty and its creditworthiness], and g) the measures already taken to address the breach.
26. A breach, which is repetitive in nature, stemming from a similar reason, triggered by a similar event or concerning a similar exposure, should not be considered as justified grounds to grant an institution more than three months to resolve the breach.
27. With respect to the overall financial situation of an institution, it might be the case that an institution holding own funds well above the minimum level required should be in a better position to absorb the potential loss in the case of a default of the counterparty. Competent authorities should take into account the institution's financial situation and consider on a case-by-case basis whether the time to implement certain measures to return to compliance should be adjusted upwards or downwards due to the potential impact on the financial situation of the institution. For example, an institution with a less favourable financial situation might need more time to implement certain measures to return to compliance or otherwise risk a worsening of the financial situation.
28. The same considerations apply when the assessment of the banking book reveals that an institution is not highly exposed to concentration risk across different counterparties. Indeed, in this case competent authorities might feel more confident allowing a longer period to return to compliance since this could suggest that the institution has incorporated a diversified risk management strategy as an established practice to manage its exposures.
29. Although the large exposures framework and the own funds requirements for credit risk have different objectives, they both operate under the assumption that a customer could default on its obligations. Specifically, the large exposures framework takes into account the risk of a counterparty when allowing exemptions (see e.g. the exemptions in Article 400(1) of the CRR for certain exposures that have a 0% risk-weight under the standardised approach for credit risk). Competent authorities might thus feel more confident allowing a longer period to return to compliance when the counterparty of an exposure has a low risk profile; conversely, they might

feel the need to ensure a more rapid return to compliance when the counterparty of an exposure has a high risk profile. Consequently, the creditworthiness of a counterparty could be a variable that competent authorities should take into account when assessing the specific time that they allow an institution to return to compliance once a breach of the large exposure limits has occurred.

30. Based on the assessment performed on the basis of those criteria, the competent authority should be in a position to determine the time considered appropriate for returning to compliance. In particular, the competent authority should decide whether the breach should be resolved within three months, or whether it should grant the institution a period longer than three months to return to compliance. In the latter case, competent authorities should in principle not grant more than one year to return to compliance, although it is also acknowledged that there could be extraordinary cases that may warrant allowing a longer timeframe. These cases should however not be the norm and well justified.

Set of measures to return to compliance

31. Article 396(3)(c) of the CRR requires the EBA to specify how competent authorities may determine the measures to be taken to ensure the timely return to compliance of the institution.
32. It is upon the institution to present a set of measures to ensure the timely return to compliance with the large exposure limits. Such measures should be to the satisfaction of the competent authority with due regard to the assessment performed of the breach of the large exposure limits. In assessing the appropriateness of the measures, the competent authority should consider whether they would assure that the specific exposure that is in breach would no longer be close to breaching the limit again in the near future.
33. When the institution is granted a period longer than three months to return to compliance, it shall provide the competent authority with a plan to return to compliance in accordance with Article 396(1) subparagraph 3 of the CRR. As a general rule, the set of measures (the compliance plan) should include the following: a) arrangements to reduce the exposure, if necessary; b) measures to increase the institution's own funds, if necessary; c) arrangements to reinforce internal risk management and control processes; d) procedures to ensure the timely implementation of the measures; and e) a detailed timetable to implement the planned measures. In any case, the institution should always include any foreseeable risks or obstacles to the effective and timely execution of the measures.
34. Competent authorities should consider whether the institution should employ further strategies, such as requesting collateral from the counterparty or any other client belonging to the same group of connected clients, acquiring eligible credit risk mitigation instruments, selling all or part of the exposure to another institution, syndicating parts of the loan, negotiating with the borrower an early repayment, or even terminating the whole transaction.
35. With regard to the arrangements to increase the institution's own funds, consideration should be given to whether this could be achieved by means of the institution issuing new capital items or retaining profits.

36. When an institution is not allowed more than three months to restore compliance with the large exposure limits, it might present a streamlined version of the compliance plan.
37. In order to ensure the effective and timely return to compliance with the large exposure limits, the competent authority should closely monitor the implementation of the compliance plan or in cases for less than three months, the measures implemented by the institution with a frequency adapted to the cause and size of the breach, its potential impact on the institution and its specificities. Whenever necessary, the competent authority should be able to request additional information, and in case the measures do not progress as initially planned, an alternative course of action should be agreed.
38. When the breach is due to a lack of internal control and inadequate risk management processes, which might lead for example to an incorrect grouping of connected clients, the competent authority should assess those processes and require specific measures to improve them, as well as encourage institutions to perform an internal or external audit regarding its internal control and risk management processes. Moreover, competent authorities could perform targeted on-site examinations.
39. In defining and implementing measures to restore the large exposure limits, institutions should consider that Article 88(1) of Directive 2013/36/EU requires that the management body of an institution should have ultimate and overall responsibility for the institution and should define, oversee and be accountable for the implementation of the governance arrangements within the institution to ensure its effective and prudent management.¹⁰ Moreover, the EBA Guidelines on Internal Governance require that the management body should set, approve and oversee the implementation of, amongst other things, an adequate and effective internal governance and internal control framework.¹¹ Furthermore, it is the role of the institution's audit committee, where established, to monitor the effectiveness of the institution's internal quality control and risk management systems and, where applicable, its internal audit function, with regard to the financial reporting of the audited institution, without breaching its independence.
40. Furthermore, the management body of an institution, in its supervisory function, should oversee the implementation of a well-documented compliance policy, which should be communicated to all staff. Institutions should set up a process to regularly assess changes in the law and regulations applicable to its activities. The compliance function should advise the management body on measures to be taken to ensure compliance with applicable laws, rules, regulations and standards, and should assess the possible impact of any changes in the legal or regulatory environment on the institution's activities and compliance framework.

¹⁰ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC. OJ L 176, 27.6.2013, p. 338–436

¹¹ EBA Guidelines on Internal Governance EBA/GL/2017

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4. Draft Guidelines

specifying the criteria to assess the exceptional cases when institutions exceed the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013 and the time and measures to return to compliance pursuant to Article 396(3) of Regulation (EU) No 575/2013

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010.¹² In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by ([dd.mm.yyyy]). In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to compliance@eba.europa.eu with the reference 'EBA/GL/201x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3) of Regulation (EU) No 1093/2010.

¹² Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

2. Subject matter, scope and definitions

Subject matter

5. These guidelines specify, in accordance with the mandate set out in Article 396(3) of Regulation (EU) No 575/2013, the criteria that competent authorities should use to assess the exceptional cases referred to in Article 396(1) of Regulation (EU) No 575/2013 and where a competent authority allows an institution to exceed the limits set out in Article 395(1) of Regulation (EU) No 575/2013. These guidelines also determine the criteria that competent authorities should use to determine the appropriate time for an institution to return to compliance with the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013, and the measures to be taken to ensure the timely return to compliance with those limits.
6. In addition, these guidelines specify additional information that should be provided to the competent authority when reporting a breach of the large exposure limit in accordance with Article 396(1) of Regulation (EU) No 575/2013.

Scope of application

7. These guidelines apply in relation to the assessment by competent authorities of the exceptional cases referred to in Article 396(1) of Regulation (EU) No 575/2013. They also apply to how competent authorities can determine the time considered appropriate for returning to compliance and the measures to be taken to ensure the timely return to compliance of the institution, including the submission of a compliance plan.
8. These guidelines do not apply to the cases set out in Article 395(5) of Regulation (EU) No 575/2013 as long as the institution fulfils the conditions laid down therein.

Addressees

9. These guidelines are addressed to competent authorities as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation No 1093/2010.

Definitions

10. Unless otherwise specified, the terms used and defined in Regulation (EU) No 575/2013 and Directive 2013/36/EU have the same meaning in the guidelines.

3. Implementation

Date of application

11. These guidelines apply from 01.03.2022

4. Exceptional cases of breaches of the large exposure limits, time and measures to return to compliance

12. Based on the information provided when reporting a breach of the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013, the information referred to in section 4.2 and other information available to the competent authority, the competent authority should perform an assessment on the basis of the criteria set out in section 4.1 of these guidelines.
13. The competent authority should inform the institution of the time granted to resolve the breach of the limits of Article 395(1) of Regulation (EU) No 575/2013, having assessed the appropriate time period in accordance with section 4.3 of these guidelines.

4.1 Criteria to determine the exceptional cases referred to in Article 396(1) of Regulation (EU) No 575/2013

14. A breach of the limits set out in Article 395(1) of Regulation (EU) No 575/2013 should always be considered as an exceptional case.
15. In order to assess a situation in which an institution has exceeded the limits of Article 395(1) of Regulation (EU) No 575/2013, a competent authority should evaluate at least the following aspects:
 - a. Frequency and number of breaches.
 - b. Predictability of the breach.
 - c. Reasons beyond control of the institution that led to inability to prevent the breach.

Frequency and number of breaches

16. The competent authority should assess whether the breach of the limits of Article 395(1) of Regulation (EU) No 575/2013 by the institution is a rare event. The assessment should take into account any other past breaches by the institution stemming from the same origin, triggered by the same event or concerning the same client or group of connected clients.

17. If an institution reports a second breach during the last 12 months that concerns the same client or group of connected clients as the first breach, the competent authority may decide that the event cannot qualify as a rare one. Equally, if an institution reports a second breach during the last 12 months that stems from the same origin as the first breach, the competent authority may decide that the event cannot qualify as a rare one.
18. If, during the last 12 months, an institution has already reported two breaches of the large exposure limits that concern a different client or group of connected clients, have a different origin and have been triggered by a different event, the competent authority, in view of other elements at hand, may decide that a third breach, and any further breaches, which is unrelated to the two other breaches may not qualify as a rare event.

Predictability of the breach

19. The competent authority should assess whether the breach would have been a foreseeable event by the institution when it had applied a proper and effective risk management in accordance with its obligations under Article 393 of Regulation (EU) No 575/2013 and the EBA Guidelines on Internal Governance¹³.
20. The competent authority should also consider whether the institution could have been in a position to anticipate the breach using available information.
21. The competent authority should be aware that, in cases where identical or similar breaches of other institutions occur that could be attributed to the same cause, it might conclude that the breach was caused by an unforeseeable event.

Reasons beyond control of the institution to prevent the breach

22. The competent authority should assess whether the breach was caused by reasons beyond the control of the institution. This could at least be assumed in the following cases:
 - a. An unexpected and substantial decrease of own funds by the institution, including due to the impact of major operational risk events, such as fraud, natural disaster or pandemic, that could not be managed adequately by the institution's internal control mechanisms.
 - b. In cases where an exposure (fully or partially) exempted ceases to be eligible for such an exemption due to a decision of a third party that could not have been anticipated or prevented by the institution.
 - c. A court ruling or administrative decision that leads to a different interpretation of the applicable large exposures regulatory framework where the institution has not had sufficient time to implement it such as to prevent a breach of the limits of Article 395(1) of Regulation (EU) No 575/2013.
23. A breach caused by an inappropriate application or misinterpretation of the large exposures framework should, in general, not qualify as a reason beyond the control of the institution.

¹³ Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11)

24. In general, if the competent authority concludes that the breach does not fulfil the criteria specified in this section, the competent authority should not grant a period longer than three months to restore compliance with the large exposure limits.

Questions for consultation

Question 1: Do you agree with the three criteria developed in the Guidelines to assess a breach of the large exposure limits?

Question 2: Is there anything in particular that should be developed further in the guidelines to provide greater clarity on each of the three criteria?

Question 3: What are your views on the quantitative criteria included in paragraphs 16 and 17? Do you think that they can provide good guidance to competent authorities to assess a breach?

Question 4: In particular on the criterion “reasons beyond control of the institution”, do you think that the cases included in the guidelines reflect accurately current practices?

4.2 Information to be provided to the competent authority in case of a breach of the large exposure limits

25. When reporting the exposure value in excess of the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013 in accordance with Article 396(1) of that Regulation, and in order to facilitate its assessment by the competent authority, the institution should, without delay, provide at least the following information:

- a. the amount of the excess and magnitude of the breach in relation to Tier 1 capital,
- b. the name of the client concerned and, where applicable, the name of the group of connected clients concerned,
- c. date of the occurrence of the breach,
- d. description of available collateral, both CRR eligible and ineligible, if any,
- e. a detailed explanation on the reasons for the breach,
- f. remedial actions already implemented or planned, and
- g. expected time needed to return to compliance with the large exposure limits.

26. The competent authority should request further information and explanations if it is not satisfied that the detail of the information provided is sufficiently complete to allow for a comprehensive assessment of the specific circumstances of the breach.

Questions for consultation

Question 5: Do you have any comments on the additional information that an institution should submit to the competent authority when a breach of the large exposure limits has occurred?

4.3 Criteria to determine the appropriate time to return to compliance with the limits of Article 395(1) of Regulation (EU) No 575/2013

27. Following the assessment of the breach reported by the institution in accordance with section 4.2 of these guidelines, the competent authority should decide the appropriate time to return to compliance with the limits of Article 395(1) of Regulation (EU) No 575/2013.
28. A competent authority should not grant an institution a period longer than three months to resolve a breach if it concludes that the breach was repetitive or when the magnitude of the breach leads to a major impact on the financial situation of the institution.
29. In cases where a competent authority decides to allow an institution a period longer than three months to resolve a breach and return to compliance with the limits set out in Article 395(1) of Regulation (EU) No 575/2013, the time deemed appropriate by the competent authority should be commensurate with a rapid restoration of the limits.
30. In any case, the time to return to compliance should not be longer than one year. Exceptionally, where the specific circumstances of the breach and the measures of the compliance plan referred to in section 4.4 justify otherwise, the competent authority may grant a period longer than one year to resolve the breach.
31. In order to decide the appropriate time to return to compliance, the competent authority should at least consider the following elements in its assessment:
 - a. the institution's record of breaches;
 - b. the promptness of notifying the breach;
 - c. the reason(s) for the breach;
 - d. the systemic nature, complexity and magnitude of the breach;
 - e. the possible impact on the overall financial situation of the institution;
 - f. the overall risk concentration in the banking book of the institution across different counterparties;
 - g. the type of client or group of connected clients and its creditworthiness;
 - h. the measures already implemented to resolve the breach.

The institution's record of breaches

32. The competent authority should take into account any previous breaches by the institution and the scope of measures adopted to return to compliance in those cases. The competent authority should in particular assess, in cases of repeated breaches, whether the new breach is stemming from the same reasons as the ones identified in previous cases.

The promptness to notify the breach or the remedial actions to return to compliance

33. If an institution unduly delays the notification of a breach, the competent authority may consider giving the institution a shorter timeframe to return to compliance.

The reason(s), or repetitive nature, complexity and magnitude of the breach

34. The competent authority should assess the reasons for the breach and assess the point in time and forward-looking materiality of the potential impact on the institution.
35. The competent authority might require and request additional information when the causes of the breach have a significant complexity.

The overall financial situation of the institution

36. The competent authority should consider whether the institution's compliance with the regulatory capital requirements (CET 1 Ratio, Tier 1 Ratio, Total Capital Ratio) is well above the minimum level.

The overall risk concentration in the banking book of the institution across different counterparties

37. The competent authority should consider the adequacy of the risk management practices of the institution and its approach to diversification.

The type of client and its creditworthiness

38. The competent authority should take into account the type of counterparty and its creditworthiness. It should assess whether the possible default of the concerned client or group of connected clients, if available, and the consequent loss, has the potential to reduce the regulatory capital ratios below the minimum requirements.

The measures already implemented to resolve the breach

39. The competent authority should consider the measures already implemented by the institution, especially in view of the fact that some of those measures might eventually facilitate a rapid return to compliance.

Questions for consultation

Question 6: Do you agree with the general principle that compliance with the large exposure limits should occur within one year?

Question 7: What cases could justify a period longer than one year to return to compliance?

Question 8: Paragraph 30 lists a number of elements that a competent authority should consider when deciding the specific time to return to compliance with the large exposure limits. Do you agree with them? Should the guidelines include further element/s? If your answer is yes, please elaborate.

4.4 Measures to be taken to ensure the timely return to compliance of the institution with the limits of Article 395(1) of Regulation (EU) No 575/2013

40. When a competent authority has granted an institution a period longer than three months to return to compliance with the limits of Article 395(1) of Regulation (EU) No 575/2013, the institution shall present a compliance plan for a timely return to compliance.
41. The compliance plan should at least encompass the following:
 - a. arrangements to reduce the concerned exposure(s),
 - b. measures to increase the institution's own funds, where necessary,
 - c. arrangements to reinforce internal risk management and control processes,
 - d. any necessary amendments to the institution's compliance policy,
 - e. appropriate procedures to ensure the timely implementation of the measures, and
 - f. a detailed timetable to implement the measures, including the intended date of returning to compliance.
42. The measures proposed by an institution should include a description of any foreseeable risks or obstacles to the effective and timely execution of the compliance plan, if required.
43. The competent authority should assess the measures to ensure in all cases for both the compliance plan and measures undertaken for periods less than three months that they are appropriate, sufficient and feasible to return to compliance on a stable and continuous basis, and that the detailed timeframe is appropriately setup and achievable.
44. If the competent authority has any material concerns with regard to the measures, it should promptly inform the institution.
45. The institution should inform the competent authority immediately in case some of the measures foreseen cannot be achieved as planned. The competent authority should closely monitor the implementation of the measures to ascertain the effective and timely return to compliance. In particular, it should monitor that the different milestones are fully accomplished. If the institution fails to achieve any of those milestones, the competent authority should require the institution to address such failings appropriately.
46. The frequency and intensity of the monitoring by the competent authority should be adequate and proportional to the cause and size of the breach, its potential impact on the institution and the specificities of the compliance plan and measures undertaken for periods of less than three months, if required. It should also consider the evolution of the concerned exposure(s), based on regular information provided by the institution. Whenever it is necessary, the competent authority should request additional information.
47. The competent authority should decide and communicate whether the institution should perform an internal or an external audit regarding internal control and risk management

processes, the results of which should be communicated to both the institution's management body and the competent authority.

48. The competent authority should have in place a standard and documented procedure with clear instructions that describe the necessary steps to monitor that institutions having notified a breach return to compliance in a timely manner.
49. Institutions should ensure, in accordance with the EBA Guidelines on Internal Governance that its management body oversees and monitors the implementation of the measures taken that ensures a duly and timely return to compliance with the limits of Article 395(1) of Regulation (EU) No 575/2013.

Questions for consultation

Question 9: Do you agree with the main content of the compliance plan as set out in paragraph 40 in order to ensure return to compliance or are some measures missing? Alternatively, do you think that some of the measures would not be necessary? Please elaborate further in either case.

Question 10: Should the guidelines benefit from including further procedural details?

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

1. Regulation (EU) 2019/876, amending the Capital Requirements Regulation (EU) No 575/2013, has added paragraph (3) to Article 396 whereby the EBA is mandated to develop guidelines to specify how the competent authorities may determine the exceptional cases referred to in Article 396(1) CRR; the time considered appropriate for returning to compliance; the measures to be taken to ensure the timely return to compliance of the institution.
2. The present analysis provides an overview of the findings as regards problem identification, possible options to remove problems and their potential impacts. Given the nature and the scope of the guidelines, and pursuant to the principle of ‘proportionate analysis’, this analysis is high-level and qualitative in nature. Only a qualitative analysis is provided about the potential impact of the options; a quantitative analysis is presented with the aim to provide information about the materiality of the phenomena here discussed.
3. The qualitative analysis presents the advantages and disadvantages of different options. Moreover, the quantitative analysis relies on information available through the Supervisory Reporting Templates (i.e. COREP) and, in particular, it leverages only on data provided in the EBA sample. This way, it is not necessary to collect information from National Competent Authorities (NCAs) or directly from the institutions¹⁴.

- A. Problem identification and baseline scenario
4. An excessive concentration of exposures towards a single client or its group of connected clients, if available is a major threat for banks’ stability. However, until recent years no clear-shared guidance were available on how to set limits on the credit risk concentration. The large exposures framework provides such guidance so acting as a backstop to significant losses caused by the possible default of a client or a group of connected clients.
5. Article 396(1) of the CRR deals with compliance aspects when the large exposure limits are breached. This flexibility can be deemed necessary once it is recognised that institutions have not complete control of the relationships they have with their customers: the behaviour of the customers, for example regarding the drawing from off-balance sheet items; the unexpected loss of a collateral that was used to reduce the exposure pursuant to the CRM rules; the impact of operational risk events such as fraud, are examples of phenomena that might shape unexpected variations of the exposures level or of the capital level.
6. Article 396(1) of the CRR states that such breaches should be exceptional and that institutions shall promptly inform the competent authority and remedy within the period indicated by the

¹⁴ Making ad hoc data collections is a costly and time-consuming process. For this reason it is preferable, whenever it is possible to exploit data that are readily available from statistical agencies and databases.

competent authority. This rule leaves ample room for interpretation in particular regarding the definition of the terms “exceptional” and “limited period” of time that the competent authority should grant to the institution as to eliminate the breach. In turn, this situation may lead to inconsistent interpretations across EU institutions and non-harmonised application of the flexibility granted by Article 396(1).

B. Policy objectives

7. The new Article 396(3) of the CRR mandates the EBA to define guidelines to specify how competent authorities may determine the exceptional cases and the time considered necessary for returning to compliance.
8. The task of providing a definition of a concept like “exceptional case” is challenging. The risk is to arrive to definitions leveraging on other unspecified concepts as “unpredictable” or suggestions referring to very generic principles like “holistic approach”. However, it is clear that given the potential materiality of the phenomena under discussion, the level playing field among EU institutions could be endangered if any guidance was not provided.
9. As to ensure a prudent and harmonized application of Article 396(1) of the CRR, “operational” definitions are needed where the term operational applies to those definitions that allow to reduce a given concept not merely to sentences, which might have only an apparent meaning but that in practice leave rooms to heterogeneous interpretations, but to actual experiences, which are at least conceptually possible.

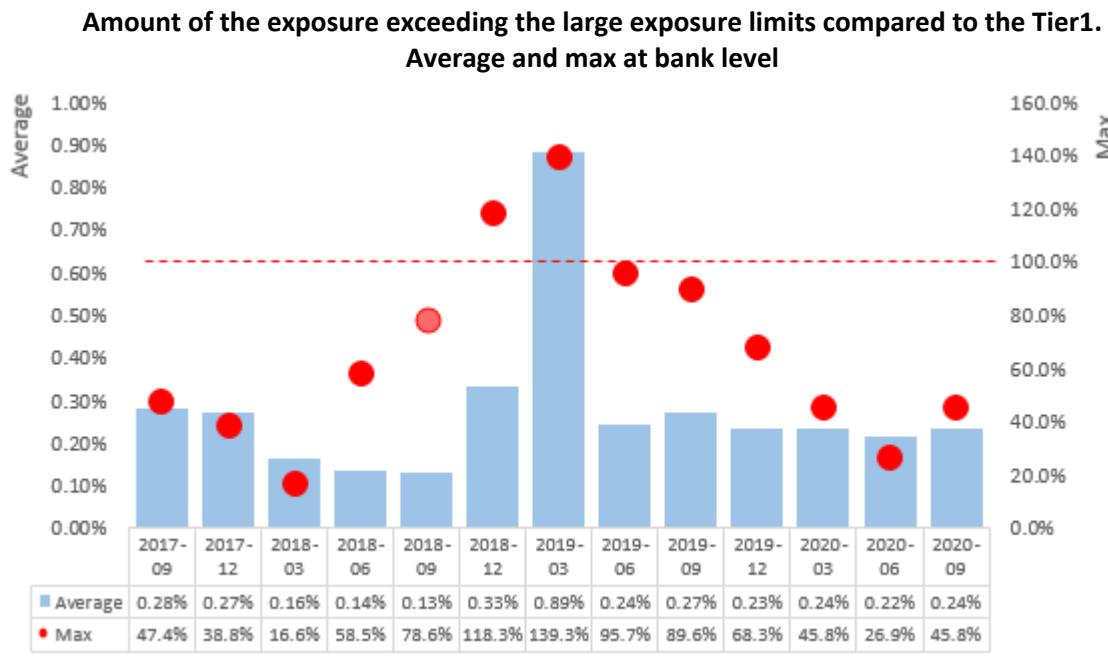
Quantitative Analysis

10. The following chart has been obtained by exploiting the information contained in the Corep templates. In particular, pursuant to Article 394 of the CRR, all exposures defined as a large exposure as per Art 392 CRR, including those exempted from the application of the limits of Article 395(1) of the CRR, must be reported. The sample analysed is constituted by about 120 banks excluding subsidiaries from 27 countries. The data are at consolidated level.
11. The chart shows the ratio between the sum of the amounts exceeding the large exposure limits and the Tier1 capital. In other terms, for each institution, the following ratio has been computed where N is the number of large exposures reported by the given institution:

$$\frac{\sum_{i=1}^N \max(0, \text{Exposure}_i - \text{Limit})}{\text{Tier1 Capital}}$$

For each period, the weighted average over the entire sample and the maximum at single bank level are represented.

12. Although, on aggregate level, the amount of exposures exceeding the Tier 1 capital is limited (0.24% in September 2020), at bank level in some cases this amount can be considerable and even higher than the Tier 1 capital.



Source: Corep

C. Options considered, Cost-Benefit Analysis and Preferred Options

13. This section presents the main policy options discussed during the development of the consultation paper, the costs and benefits of these options, as well as the preferred options retained in the consultation paper.

Scope of the guidelines

14. The common framework presented in these guidelines is based on practices developed by competent authorities and their experience. To inform the developments of the guidelines, a survey was conducted to ascertain current practices by competent authorities in the case of breaches of the large exposure limits. Through this survey, information about the materiality of the problem (i.e. breaches of the large exposure limits) and the measures taken was collected.
15. The guidelines state clearly that all the breaches of the limits of Article 395(1) should be considered as “exceptional”. This implies that any breach should be investigated by the competent authority without exception. The guidelines also establish the minimum content of such investigations and specify that the authority should assess the compliance plan that the institutions must submit for periods longer than three months and monitor closely the implementation. As such, the guidelines establish some specific obligations for both the institutions and the competent authority.

16. However, and following the mandate under Article 396(3) of the CRR, the guidelines introduce a differentiation between the breaches that should be resolved within three months and the breaches for which a longer period of time could be granted. In this sense, the need to introduce some flexibility has been preserved. It is left to the competent authority to decide whether a given breach should be resolved in three months or more time can be granted but this decision should follow an assessment based on criteria defined in the guidelines. For example, a recurrent breach, i.e. a breach generated by the same borrower, should not be considered as eligible for granting a longer period. The guidelines also require to verify if the breach can be considered similar to breaches generated by other borrowers. Also in this case, the breach should be resolved within three months.
17. Further criteria refer to situations that are out of the control of the institution. For example, a position entered into default that breaches the large exposure limits could require a considerable period to be resolved due to the times of the insolvency procedures.
18. The guidelines also provide some principles to help the competent authority to set the period of time that should be granted and state that, as general rule, a period longer than one year should be granted only in exceptional circumstances.
19. Finally, the guidelines mandate the competent authority to assess the compliance plan that the institutions are asked to submit and to closely monitor its implementation.

Scope of application

20. The main options considered as regards the scope of application are three:
 1. No action.
 2. Deduct from the institution own capital the amount of the exposure that exceed the large exposure limits.
 3. Impose a fine for any breach.
21. As regard the first point, i.e. the typical “zero” option, it should be taken into consideration whenever the costs of the proposed regulation is deemed higher than the benefit. In this specific case, where the potential damage shaped by the default of a large exposure is high even if infrequent, the materiality of the phenomena suggests that measures going in the direction of reducing the potential impact have an high expected benefit. Moreover, the guidelines do not impose structural costs, like additional reporting requirements, but set some common principles that help to increase the harmonization among EU institutions. Finally, the guidelines introduce a form of flexibility, i.e. the possibility to grant a longer period to eliminate the eventual breach that is not directly obtainable by the reading of the Article 396(1) of the CRR. In this sense, the guidelines reduce the cost of the compliance to the regulation.
22. The guidelines do not introduce any differentiation between smaller and larger institutions, as it could be expected in compliance with the proportionality principle. However, it must be recognized that the problem of possible excessive concentration of the credit portfolio can affect equally both type of institutions and the complexity of the relationships between a given institution and its borrowers is related to the level of sophistication of the products offered by

the institution. In turn, this level should be in line with the ability of the institution's management to deal with these facility types. In addition, it must be noticed that breaches stemming from the trading book are outside the scope of the guidelines.

23. The second option, i.e. deducting from the institution own capital the amount of the exposure that exceed the large exposure limits, would automatically ensure that the limits are never breached. It is easy to show that, if E is the amount of the exposure and K the amount of Tier 1 capital then, subtracting from both E and K the amount A computer as:

$$A = \max(0, \frac{4E - K}{3})$$

would ensure that the exposure never exceed the limit of the 25% of the Tier 1.

24. This approach is simple but its main problem is the lack of flexibility. The reduction of the capital due to the deduction could lead to a breach of other prudential limits, like the capital ratio limits, but could also cause other exposures to breach the large exposure limits so triggering other deductions. This cascading effect could challenge the stability of the institution.
25. Imposing a fine has an interesting theoretical appeal. As mentioned above, defining the exceptionality of a given situation is a difficult task. This is mainly so because it is difficult, if not impossible, for any external analyst to have a complete knowledge of the information available to the institution. The fine would induce the institution to try limiting as much as possible the occurrence of the breaches so to minimize the amount of the fine. In case a breach is observed, it could be considered as an event not foreseeable or that could not be prevented by the institution.
26. The main practical problem of this approach is the calibration of the fine. If not adequate, the fine would not give the correct incentive and if excessive, it could affect the stability of the institution.

Preferred option

27. The guidelines introduce a quite broad interpretation of the concept of "exceptional case" referred to in Article 395(1). The rationale for this interpretation is that the breaches to large exposure limits, if not well monitored or promptly cured, could have a large impact on the solvency of the institutions.
28. Considering both the possible materiality of losses stemming from large exposures and the need to ensure a harmonised application of the regulation across EU institutions, it is deemed that the benefits of the guidelines compensate the costs and represent the better solution among the alternative options.

5.2 Overview of questions for consultation

Question 1: Do you agree with the three criteria developed in the Guidelines to assess a breach of the large exposure limits?

Question 2: Is there anything in particular that should be developed further in the guidelines to provide greater clarity on each of the three criteria?

Question 3: What are your views on the quantitative criteria included in paragraphs 16 and 17? Do you think that they can provide good guidance to competent authorities to assess a breach?

Question 4: In particular on the criterion “reasons beyond control of the institution”, do you think that the cases included in the guidelines reflect accurately current practices?

Question 5: Do you have any comments on the additional information that an institution should submit to the competent authority when a breach of the large exposure limits has occurred?

Question 6: Do you agree with the general principle that compliance with the large exposure limits should occur within one year?

Question 7: What cases could justify a period longer than one year to return to compliance?

Question 8: Paragraph 30 lists a number of elements that a competent authority should consider when deciding the specific time to return to compliance with the large exposure limits. Do you agree with them? Should the guidelines include further element/s? If your answer is yes, please elaborate.

Question 9: Do you agree with the main content of the compliance plan as set out in paragraph 40 in order to ensure return to compliance or are some measures missing? Alternatively, do you think that some of the measures would not be necessary? Please elaborate further in either case.

Question 10: Should the guidelines benefit from including further procedural details?