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Public hearing on the RTS on Extraordinary circumstances for continuing the use of an internal model

20 September 2023, 15:00 – 16:00 (virtual)

EBA Roadmap on MKR & CCR mandates under CRR2

Priorities	EBA regulatory products	Mandate in CRR	Legal Deadline	Status
Phase 1: Implementation of the SA-CCR and of essential parts of the FRTB revisions for the IMA	Report on the impact of the FRTB	Article 519b(1)	30 September 2019	Delivered
	RTS on mapping of derivatives transactions to risk categories under the SA-CCR	Article 277(5)(a) and (b)	28 December 2019	In force
	RTS on the supervisory delta formula for interest rate options and determination of long or short positions under the SA-CCR	Article 279a(3)(a) and (b)	28 December 2019	In force
	RTS on liquidity horizons for the IMA	Article 325bd(7)(a),(b),(c),(d)	28 March 2020	In force
	RTS on backtesting requirements and PLA requirements under the IMA	Article 325bf(9) and Article 325bg(4)(a),(b),(c),(d),(e)	28 March 2020	In force
	RTS on assessment of risk factor modellability under the IMA	Article 325be(3)	28 March 2020	In force
Phase 2: Implementation of the FRTB reporting requirements (FRTB SA) and of essential parts of the FRTB revisions for the IMA and for the treatment of non-trading book positions subject to FX or commodity risk	ITS on specific reporting requirements for market risk (FRTB SA)	Article 430b(6)	30 June 2020	In force / Finalisation
	RTS on a stress scenario risk measure for non-modellable risk factors under the IMA	Article 325bk(3)(a)(b)(c)(d)	28 September 2020	Delivered
	GL on criteria for the use of data inputs in the risk-measurement model under the IMA	Article 325bh(3)	28 September 2020	In force
	RTS on PDs and LGDs for the default risk model under the IMA	Article 325bp(12)	28 September 2020	In force
	RTS on treatment of non-trading book positions subject to FX or commodity risk	Article 325(9)	28 September 2020	In force
Phase 3: Implementation of the FRTB reporting requirements (FRTB IMA) and of the regulatory products related to the FRTB SA	ITS on specific reporting requirements for market risk (FRTB IMA)	Article 430b(6)	30 June 2020	Finalisation
	RTS on instruments exposed to residual risk	Article 325u(5)	28 June 2021	In force
	RTS on emerging markets and advanced economies	Article 325ap(3)	28 June 2021	In force
	RTS on gross jump-to-default (JTD) amounts	Article 325w(8)(a),(b),(c)	28 June 2021	In force
Phase 4: Regulatory products whose substance will be derived from the monitoring of the application of the revised frameworks	RTS on material extensions and changes under the IMA	Article 325az(8)(a)	28 June 2024	In progress
	RTS on the assessment methodology for the IMA	Article 325az(8)(b)	28 June 2024	Finalisation
	RTS on extraordinary circumstances for being permitted to continue using the IMA	Article 325az(9)(a)	28 June 2024	Under consultation
	RTS on extraordinary circumstances for being permitted to limit the backtesting add-on	Article 325az(9)(b)	28 June 2024	Under consultation
	GL on the meaning of exceptional circumstances for the reclassification of a position	Article 104a(1)	28 June 2024	Postponed
	Report on the impact and relative calibration of the SA-CCR, simplified SA-CCR and OEM	Article 541(1)	28 June 2023	Delivered



Purpose of the RTS

The RTS

Define what extraordinary circumstances are

And

Provide indicators supporting the identification of extraordinary circumstances

If extraordinary circumstances are acknowledged, the competent authority can grant an institution the permission

- to **continue using its alternative internal models** for the purpose of calculating the own funds requirements for the market risk of **a trading desk that no longer meets the conditions** referred to in point (c) of paragraph 2 of this Article and in Article 325bg(1) (Article 325az CRR)
- to limit the **add-on** to the one resulting from **overshootings under back-testing hypothetical changes**
- **exclude overshootings** resulting from the back-testing of hypothetical or actual changes from the calculation of the add-on as referred to in Article 325bf(6) *CRR (if amendment is included in CRR3)*

in accordance with Article 325az(9) CRR.

What are extraordinary circumstances (I)

In line with the Basel framework, the RTS defines extraordinary circumstances as

(i) a **period of**

significant cross-border financial market stress or

major regime shift (associated with a level of stress similar to that of a crisis)

that

(ii) renders the **outcome** of the back-testing or of the PLAT **inappropriate**.

The 250 business days considered in the back-testing / PLAT need to include some days/weeks/months qualifying as period of extraordinary circumstances

BCBS, MAR32.45

There may, on very rare occasions, be a valid reason why a series of **accurate** trading desk level **models across different banks** will **produce many back-testing exceptions or inadequately track the P&L** produced by the front office pricing model (for instance, during **periods of significant cross-border financial market stress affecting several banks** or when financial markets are subjected to a **major regime shift**).

One possible supervisory response in this instance would be to permit the relevant trading desks to continue to use the IMA but require each trading desk's model to take account of the regime shift or significant market stress as quickly as practicable while maintaining the integrity of its procedures for updating the model.

Supervisory authorities should only pursue such a response under **the most extraordinary, systemic circumstances**.

What are extraordinary circumstances (II)

In line with the Basel framework, the RTS defines extraordinary circumstances as

(i) a **period of**

significant cross-border financial market stress or

major regime shift (associated with a level of stress similar to that of a crisis)

that

(ii) renders the **outcome** of the back-testing or of the PLAT **inappropriate**.

Q3. What kind of regime shifts would you expect to render the outcome of the back-testing/PLAT inappropriate?

Q4. How do you expect the PLAT results to be affected or to deteriorate during a period of financial stress or a regime shift, and what are the reasons for your expectation?

Indicators for identifying extraordinary circumstances

Challenge

The nature/source/qualities of financial market stress and regime shifts will be different every time.

Characteristics that should be taken into account:

- Volatility levels comparable to or exceeding those observed during the global financial crisis or COVID-19 pandemic
- Sudden manifestation of increased volatility levels

... but: **No automatism.** Other indicators reflective of the nature of the financial market stress / regime shift are to be considered

Q1. Besides volatility indices, are there any other factors or indicators, that could be used to identify situations of significant cross-border financial market stress or of a major regime shift?

Q2. Do you agree with the approach presented in the RTS? If not, please clarify which alternative approach could be used or which additional aspects should be taken into consideration.

Consultation responses



EBA Public

Please remember to provide

your written response

by submitting it via the

[EBA consultation paper page.](#)

Deadline: **3 November 2023**

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