Draft RTS on the determination of the overall exposure to clients in respect of transactions with underlying assets (CP/2013/07)

Public hearing

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EBA tasks

Common rulebook

Maximum harmonisation

...but proportionate to different financial institutions

EU Commission
Sectoral Directives

EU Commission
'Implementing legislation'

EBA to
provide advice

EBA developing binding
technical standards

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EBA process

> The CRR contains a specific mandate for the EBA to develop draft Regulatory Technical Standards ('RTS') related to Large Exposures. These RTS will be part of the single rulebook enhancing regulatory harmonisation in the EU.

> Development of the draft RTS by a EBA's Subgroup with the support of EBA Staff (policy and legal experts).

> Cost-benefit and Impact Assessment analysis of proposals carried out according to EU standards.

> Adoption of draft proposals by the EBA Board of Supervisors.

> Public consultation and consultation of the Banking Stakeholders Group.

> Analysis of the feedback received and review of the proposal.

> Adoption of the draft RTS by the EBA Board of Supervisors, publication and submission to the EU Commission.

Mandate

> In accordance with Article 379(8) of the proposed CRR (i.e. Article 390(8) of the final CRR), the draft RTS specifies:

– the conditions and methodologies used to determine the overall exposure of an institution to a client or a group of connected clients in respect of exposures through transactions with underlying assets;

– the conditions under which the structure of transactions with underlying assets does not constitute an additional exposure.

Calculation of the relevant exposure value

> The calculation of the total exposure to a certain obligor that results from exposures to a transaction with underlying assets requires that, as a first step, the exposure value is identified separately for each exposure.

Calculation of the relevant exposure value: CIUs (1)

> Where the exposures of other investors rank *pari passu* with the institution's exposure – e.g. CIUs – the losses are distributed among investors in accordance with the percentage of their participation in the transaction.

> This proportional loss-sharing affects all names in the underlying portfolio in an equal way and it is not dependent on which name defaults first.

> The determination of the exposure value of an exposure to an underlying asset reflects the pro-rata distribution of losses.

Calculation of the relevant exposure value: CIUs (2)

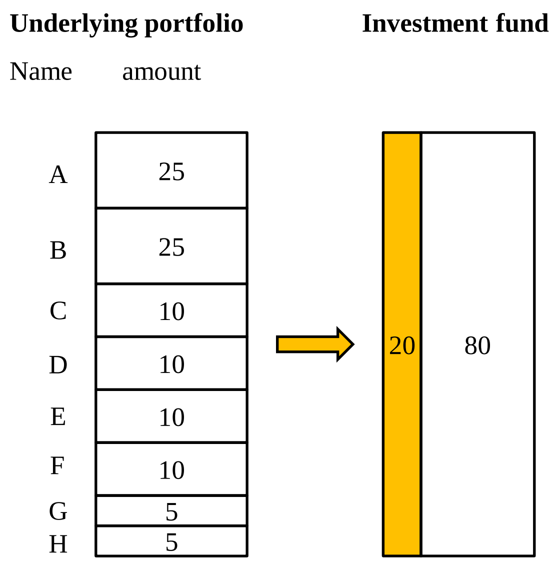
> Institution's investment in the transaction: 20

> The pro-rata ratio for the institution's exposure to the transaction: 1/5 (20/100)

> The institution assigns an exposure of:

- 5 to underlyings A and B (1/5*25)
- 2 to underlyings C to F (1/5*10)
- 1 to underlyings G and H (1/5*5)

Example 1



Calculation of the relevant exposure value: securitisation (1)

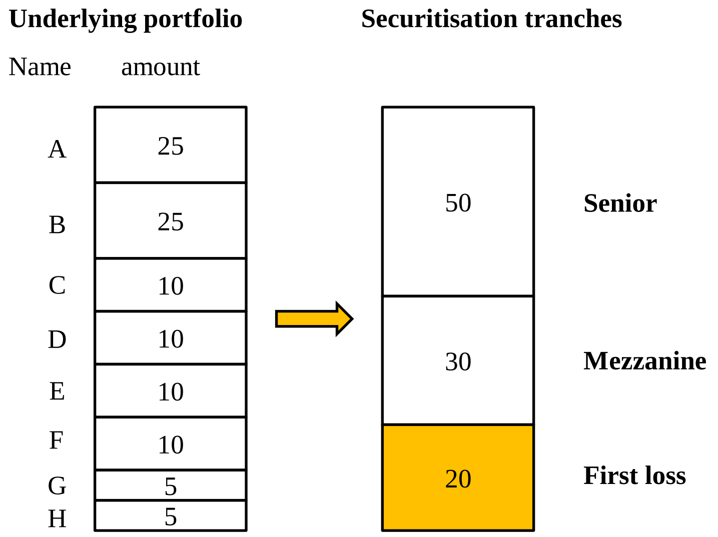
> Where the exposures rank differently – e.g. securitisations – losses are distributed first to a certain tranche and then, where there is more than one investor in this tranche, amongst the investors on a pro-rata basis.

> The maximum loss to all investors in a certain tranche is limited by the total exposure value of this tranche and it cannot exceed the exposure value of the exposure formed by the underlying asset. The procedure for recognising the pro-rata distribution of losses amongst all exposures that rank *pari passu* in this tranche (where there is more than one investor) is then applied to the lower of the two exposure values.

Calculation of the relevant exposure value: securitisation (2)

> Institution's investment in the first loss tranche: 20

Example 2



> The pro-rata ratio for the institution's exposure to the transaction:1 (this ratio is multiplied with the lower of the exposure value of the underlying and the value of the first loss tranche)

> The institution assigns an exposure of:

- 20 to underlyings A and B (1*Min(25;20))
- 10 to underlyings C to F (1*10)
- 5 to underlyings G and H (1*5)

Calculation of the relevant exposure value: securitisation (3)

> Institution's investment in the senior tranche: 20

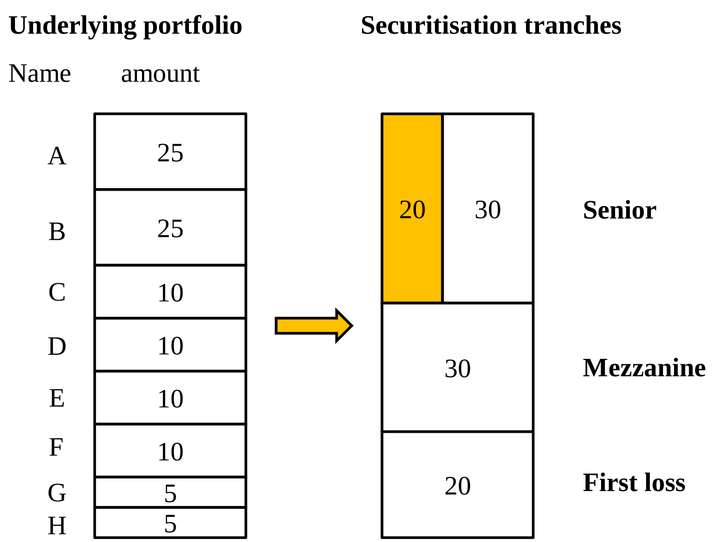
> There are other investors participating in the senior tranche with 30 ranking *pari passu*

> The pro-rata ratio for the institution's exposure to the transaction: is 2/5 (20/50). (this ratio is multiplied with the lower of the exposure value of the underlying and the value of the senior tranche, which is in all cases the value of the underlying)

> The institution assigns an exposure of:

- 10 to underlyings A and B (2/5*25),
- 4 to underlyings C to F (2/5*10), and
- 2 to underlyings G and H (2/5*5).

Example 3



Calculation of the relevant exposure value: securitisation (4)

> Institution's investment in the senior tranche:10

> There are other investors participating in the senior tranche with 40 ranking *pari passu.*

> The pro-rata ratio for the institution's exposure to the transaction is 1/5 (10/50) (this ratio is multiplied with the lower of the exposure value of the underlying and the value of the senior tranche, which is in all cases the value of the underlying)

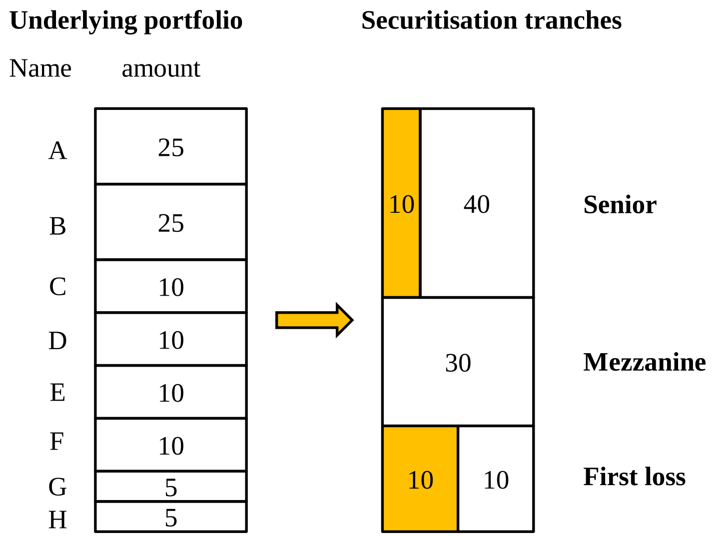
> Institution's investment in the first loss piece:10

> The pro-rata ratio is 1/2 (10/20)

> The institution assigns an exposure of:

- 15 to underlyings A and B (1/5*25 + 1/2*Min(20;25))
- 7 to underlyings C to F (1/5*10 + 1/2*10)
- 3.5 to underlyings G and H (1/5*5 + 1/2*5)

Example 4



Determination of the contribution of the underlying exposures

> General rule: look-through approach to identify the obligors of all credit risk exposures underlying the transaction.

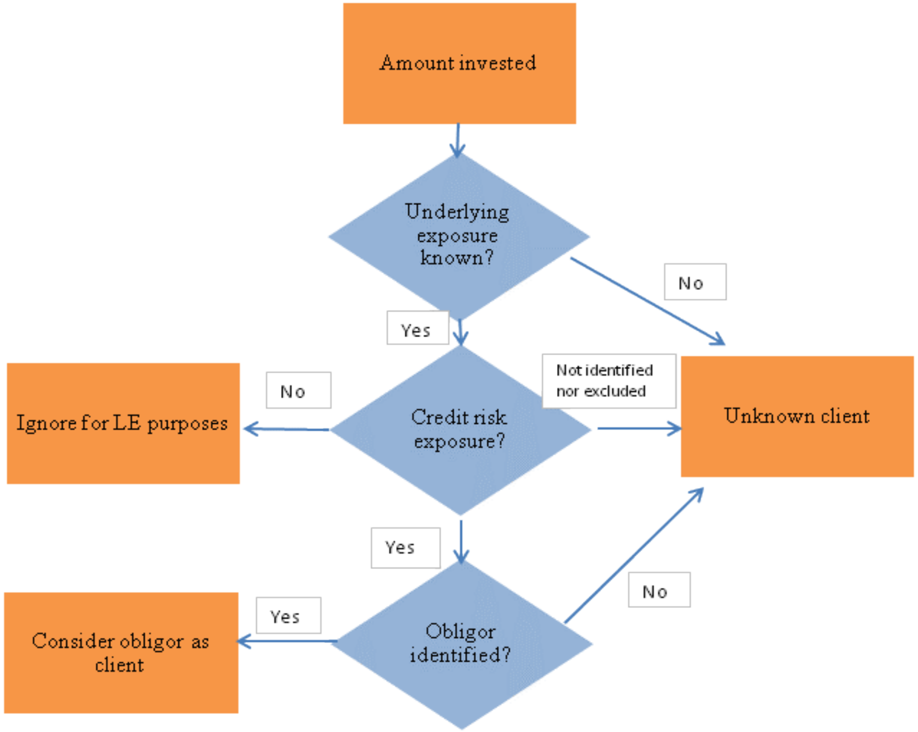
> Where an institution is not able to identify the obligors of underlying exposures: → adds all these exposures to the same hypothetical 'unknown client'.

> Where an institution is not able to distinguish between the underlying assets of a transaction: → adds the total exposure to the transaction also to the hypothetical 'unknown client' (as it cannot be excluded that the total investment creates a single exposure to a certain obligor).

> The large exposures limit applies to the 'unknown client'.

Determination of the contribution of the underlying exposures

To illustrate:



Additional exposure stemming from the structure of the transaction

> A transaction does not constitute an additional exposure only when it can be ensured that losses on an exposure to this transaction can only result from events of default for underlying assets.

Next steps

- 16 August 2013: Close of the public consultation. Your written comments/input are welcomed!

- Sept-Oct 2013: Review of the draft RTS in light of the feedback received during the consultation.

- Nov-Dec 2013: Internal approval procedure by the EBA

- Dec 2013: Delivery of the Draft RTS to the Commission for adoption (+ publication in the website).

The floor is yours!