EBA European Banking Authority

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Final Draft Regulatory Technical Standards

on the method for the identification of the geographical location of the relevant credit exposures under Article 140(7) of the Capital Requirements Directive (CRD)

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1. Executive summary

The CRD IV package has introduced a countercyclical buffer (CCB) to protect the banking system against potential losses when excess credit growth is associated with an increase in system wide risk.

National authorities will be required to monitor credit growth in relation to GDP and other relevant measures and assess whether credit growth is excessive and is leading to the build-up of system-wide risk. Based on this assessment, national authorities will set a country-specific CCB rate. This rate can be set between zero and 2.5 % or even higher when justified, thus resulting in an additional common equity tier 1 (CET1) capital requirement for financial institutions.

For banks operating in more than one jurisdiction, the buffer rate will be a weighted average of the rates in the different countries, where the weights to be applied are the own funds requirements for the credit risk of the bank's various local portfolios. As outlined in Article 136(4) CRD, this institution-specific rate is then to be multiplied by the total risk exposure amount to determine the buffer amount required.

As a first step, cross-border banks must assess the proportion of their exposures in each jurisdiction and therefore they need to identify the geographical location of their relevant credit exposures in order to establish their exact institution-specific buffer rate. The relevant credit exposures under Article 140 CRD include credit risk exposures in all exposure classes (other than exposures to governments and credit institutions) that are subject to own funds requirements for credit risk, for specific risk or incremental default and migration risk (incremental risk charge – IRC), or for securitisation positions. These draft regulatory technical standards (RTS) set out how to identify the geographical location of all relevant credit exposures.

Following the Basel III text regarding the countercyclical capital buffer, the geographical location of relevant credit exposures should reflect the ultimate risk of an institution's loan portfolios. These draft regulatory technical standards identify the ultimate risk location as the residence of the obligor rather than the location of the entity that has generated (booked) these exposures.

Regarding credit risk exposures, the obligor principle should be the main principle to determine the geographical location for the calculation of the countercyclical buffer rate. However, some exceptions are included. For specialised lending such as project finance, the geographical location of the ultimate risk should be determined on the basis of the location of the source of income. Furthermore, it is allowed for institutions to determine the geographical location of CIU exposures as the location of the institution, if determining the obligor of the underlying exposure is unduly burdensome. Also for exposures to non-credit-obligation assets, institutions can determine the geographical location as the location of the institution, in cases the obligor cannot be identified.

Turning to trading book exposures, the ultimate risk location should be the country where the debtor of the underlying credit, security or derivatives contract resides. For institutions calculating the own fund requirements of their trading book exposures using internal models, the geographical location of their trading book exposures should be determined by applying the ratio of own fund requirements of the sub-portfolio split according to the geographical location to the sum of the own fund requirements of the sub-portfolios split according to the geographical location.

Finally, for securitisation exposures, the location should be where the obligor(s) reside. However, institutions may also determine the geographical location at the place of the obligor of the underlying exposures with the highest proportion in the underlying securitisation exposures. Furthermore, securitisation exposures for which information on underlying securitisation exposures are not available or are difficult to obtain, may be allocated to the place of the institution.

These regulatory technical standards also take into account proportionality and materiality considerations for institutions with limited foreign exposures. This is intended to alleviate the burden for smaller institutions which tend to have limited foreign and trading activity. Institutions can always choose to allocate according to the underlying exposures geographically, but may choose to simplify the identification. Specifically, for institutions that have an aggregate credit exposure below 2% of the aggregate of credit, trading and securitisation exposures can choose to allocate these exposures to the place of the institution. For trading book exposures, institutions whose total trading book exposures does not exceed 2% of their total credit, trading book and securitisation exposures, may allocate these exposures to the place of the institution. Finally, for securitisation exposures, institutions may determine the geographical location at the place of the obligor of the securitisation exposure with the highest proportion in the underlying securitisation exposures.

2. Background and rationale

2.1 Rationale for the countercyclical buffer and the geographical location of exposures

Article 140 CRD sets out how the countercyclical buffer should be calculated. The CCB is a capital buffer that is increased or reduced in a countercyclical manner according to changes in the systemic component of credit risk over time. The purpose is to protect the banking system against potential losses when excessive credit growth is associated with an increase in system-wide risk.

The CCB is expected to have a direct effect on the resilience of the banking system; when risks appear, the additional capital will help the system to absorb losses while continuing to provide credit to the real economy. In so doing, the CCB should counter the pro-cyclical amplification of shocks via the banking system to the real economy which has been one of the most destabilising elements of the financial crisis. As a possible positive side effect, the CCB may help to counter the expansionary phase of the credit cycle by reducing the supply of credit and/or increasing its cost.

Under the capital requirement rules in the European Union, each Member State will designate a public authority or body that will be responsible for the quarterly setting of the CCB rate for exposures located in that Member State. Designated authorities will be required to monitor both credit growth in relation to GDP and other relevant variables, and assess whether growth is excessive and is leading to the build-up of system-wide risks. National designated authorities will set a CCB rate based on this assessment.

The buffers to be held by individual institutions will be calculated according to the countries in their whole cross-border credit portfolio by using a combination of the rates in each country. Banks operating in more than one jurisdiction will have to assess the proportion of their exposures in each jurisdiction. The institution-specific CCB rate for banks with cross-border activities will depend on the geographical location of their credit portfolios, and not on the location of the institutions that hold these exposures. The geographical location of exposures should be based on an 'ultimate risk' principle and not on the location where the exposure was booked.

Banks will need to look at the geographical location of their relevant private sector credit exposures and calculate their CCB as a weighted average of the rates applied in jurisdictions where they have credit exposures. A bank loan to a private sector entity located in any given jurisdiction will attract the same buffer requirement for that jurisdiction, irrespective of the location of the bank providing the loan.

After identifying the geographical location of an institution's credit risk exposures, the institution's specific buffer rate can be set. As an example, if the CCB rates in countries A, B and C are 2%, 1% and 1.5% of total risk exposure amount respectively, all loans to counterparties in country (A) will attract the same buffer requirement (2%), irrespective of the location of the bank granting the loan. A bank with 60% of its own funds requirement with country A counterparties, 25% of its own funds requirement with country B counterparties and 15% of its own funds requirement with country C counterparties would be subject to an overall CCB rate equal to the weighted average of the rates applied in A, B and C (2%*0.6 + 1%*0.25 + 1.5%*0.15=1.68%). This institution-specific rate is then to be multiplied by total risk exposure amount, as outlined in Article 136(4) CRD, which will give the buffer amount required.

2.2 Rationale for the location of different credit risk exposures

Article 140(4) CRD lays down that the exposures to be included in the calculation of the institution-specific countercyclical buffer rate 'shall include all those exposure classes, other than those referred to in points (a) to (f) of Article 112 of Regulation (EU) No 575/2013' (CRR). This therefore includes all credit risk exposures, except those to governments and financial institutions, which are subject to own funds requirements for credit risk under Part Three, Title II CRR; or, where the exposure is held in the trading book, are subject to own funds requirements under Part Three, Title IV, Chapter 2 CRR for specific risk or incremental default and migration risk under Part Three, Title IV, Chapter 5; or, where the exposure is a securitisation, are subject to own funds requirements under Part Three, Title II, Chapter 5 CRR.

Credit risk exposures

For the credit risk exposures under Article 140(4)(a) CRD, the geographical locations should depend on the geographical location of the institution's portfolios, and not on the geographical location of the institution that generates these exposures.

For the purposes of these RTS, the EBA considers that the ultimate risk basis may be applied in different ways: first, as the residence of the obligor as opposed to the booking of the exposure (the obligor principle); second, as the residence of the obligor, or if collateral or guarantee exist, the country where the collateral or guarantor resides (the guarantor principle); finally, as a mix of the two depending on the structure of the credit transaction, such as basing it on the source of income.

The general objective of the CCB is to protect the banking system against potential losses when excess credit growth is associated with an increase in system-wide risk. By anchoring the CCB to credit variables, such as the deviation of the ratio of credit-to-GDP from its long-term trend (henceforth the 'credit-to-GDP gap'), the CCB focuses on protecting the banks from the build-up of system-wide vulnerabilities. The CCB builds resilience into the banking system by actively encouraging the setting of buffers in boom times (when risks are taken on but, arguably, are not fully reflected in prices) and by releasing them in bad times.

With the objective of the CCB in mind, it is most appropriate to use the obligor principle; this will help to build capital in the country of residence of the obligor (regardless of where the collateral of these exposures is located), as the residence of the obligor will, in most but not all cases, be closely linked to the relevant economy.

The EBA has therefore opted to use the residence of the obligor as a the guiding principle, except for a particular type of projects, namely specialised lending exposures, which typically include project financing, where the geographical location will be based on where the income is generated, i.e. the source of income. The EBA believes that the source of income would be more appropriate for specialised lending exposures and has consequently chosen to deviate from the obligor principle in this case. Furthermore, it is allowed for institutions to determine the geographical location of CIU exposures as the location of the institution, if determining the obligor of the underlying exposure is unduly burdensome. Also for exposures to non-credit-obligation assets, institutions shall determine the geographical location as the location of the institution. These exceptions are made because determining the geographical location of CIU exposures and exposures to non-credit-obligation assets may not be feasible.

If an institution has minor cross-border activities, the effort required to monitor CCB rates within the EU is limited while the effort needed to track cross-border exposures to calculate the proportion of the relevant credit exposure to be assigned to each jurisdiction could be considered unduly burdensome. To achieve a proportionate approach towards banks with very limited cross-border activities, institutions with a total share of non-domestic activities below a pre-specified threshold of 2% of their aggregate credit, trading and securitisation risk weighted exposures will not be obliged to identify the geographical distribution of these exposures. As a simplifying methodology, all credit risk exposures in these cases can be assigned to the domestic jurisdiction of the institution; the maximum error in the calculation of the capital requirement ought to be only 0.05%[1]. It should be clear that the use of this threshold does not exempt institutions from actually applying their institution-specific CCB rate to their total risk exposure amount as stated in Article 130 CRD, including those generated by those foreign exposures falling below the 2% threshold.

[1] For CCB country rates up to 2.5%.

Trading book exposures

The geographical location of trading positions will generally be defined as the country where the debtor of the underlying credit, security or derivatives contract resides. It should be noted that trading book exposures do not refer to the full trading book, but only exposures as defined in Article 140(4)(b), i.e. credit risk on exposure is held in the trading book as regards specific risk or incremental default and migration risk.

Institutions using the standardised approach to calculate their own fund requirements stemming from trading book exposures, shall determine the geographical location of these exposures as the location of the debtor. This is done in a straightforward manner for institutions using the standardised approach, whereas the approach to determine the geographical location of trading book exposures calculated using the advanced method is less straightforward as own fund requirements for trading book exposures under the advanced method are calculated on a portfolio basis. The approach taken therefore requires institutions to determine the own fund requirements stemming from the internal model on a sub-portfolio basis (i.e. on an individual country basis) and use this to allocate exposures. It should be noted that the own funds requirements determined on a sub-portfolio basis will not equal to the own fund requirements stemming from the internal model on all relevant trading exposures, as the diversification benefits across countries are taken into account. Therefore, these draft RTS determine the geographical distribution of trading book exposures as the ratio of the country-specific share of own fund requirements obtained from their internal model to the sum of the own fund requirements from the application of their internal model to the individual countries.

Given the more volatile nature of trading book positions, the impact of the trading book on limiting excess credit growth may be limited and, for many institutions, these positions are likely to comprise a relatively small part of relevant credit exposures for the purposes of the CCB. A proportionate approach to identifying the geographical location of the trading book has therefore been introduced.

A materiality threshold of 2% for the purposes of identifying the geographical location of these exposures has therefore been introduced. As a general rule, institutions should always allocate their trading book exposures, but institutions which fall under this threshold may choose to allocate these trading book positions to the country of the institution. The threshold is set in terms of the own funds requirements for the trading book positions referred under Article 140(4)(b) CRD relative to the own funds requirements identified under Article 140(4)(a) to (c) CRD. This will ensure that only institutions with material trading book positions will be required to identify the geographical locations of these positions and this appears to strike an appropriate balance between the operational burden of identifying the geographical location and the prudence of the measure.

Again, it should be made clear that the use of this threshold does not exempt institutions from actually applying their institution-specific CCB rate to their total risk exposure amount as stated in Article 130 CRD, including those generated by those trading book exposures falling below the 2% threshold.

Securitisation exposures

The approach for securitisation exposures is a look-through approach. For securitisation exposures under Article 140(4)(c) CRD the location shall be that of the obligors of the underlying exposures. If these obligors are located in multiple jurisdictions, the location of a securitisation exposure may be the jurisdiction of those obligors having the largest proportion of the underlying exposures. Furthermore a fall-back method has been introduced, where no information is available on underlying exposures. In this case, these securitisation exposures may be allocated to the place of the institution.

2.3 The nature of these RTS under EU law

These draft RTS are produced in accordance with Article 10 of the EBA Regulation[2]. Pursuant to Article 10(4) of the EBA Regulation, these RTS shall be adopted by means of a regulation or decision. Under EU law, EU Regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that enactment in national law is not only unnecessary but also prohibited by EU law, except insofar as this is expressly required by the Member States.

Shaping these rules in the form of a regulation would ensure a level playing field by preventing diverging national requirements and easing the cross-border provision of services. Currently, an institution that wishes to begin working in another Member State has to apply different sets of rules.

The EBA has developed these draft RTS on the basis of the Directive 2013/36/EU of the European Parliament and of the Council (CRD). The EBA must submit these draft technical standards to the Commission by 1 January 2014.

[2] 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.

3. Draft regulatory technical standard on the method for the identification of the geographical location of the relevant credit exposures under Article 140(7) of the Capital Requirements Directive (CRD)

In the text of these draft RTS/ITS/Guidelines/Advice that follow, there are occasionally further explanations on specific aspects of the draft, either offering examples or providing the rationale behind a provision, or setting out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

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supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards on the identification of the geographical location of the relevant credit exposures for the purposes of the countercyclical capital buffer under Article 140(7).

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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, and in particular to Article 140(7) thereof,

Whereas:

(1) The calculation of the institution-specific countercyclical capital buffer rates requires that the location of the own funds requirements for all credit exposures of a specific institution, including exposures held in the trading book and all securitisation exposures, are identified geographically.

(2) The geographical location should follow from the location of the risk of the exposures. This will ensure that the build-up of additional reserves from implementing the countercyclical buffer is allocated to the jurisdiction with excess credit growth.

(3) The place of residence of the obligor or of the debtor should be generally used for determining the geographical location of all credit exposures as this is considered to best reflect the location where the risk is situated and which is, therefore, of importance to the financial system. However, the geographical location of credit exposures identified as specialised lending exposures under in Article 147(8) of Regulation (EU) No 575/2013 should be based on the location of the assets generating the income, that is the primary source of repayment of the obligation.

(4) Exposures of an institution to a legal person should be allocated to the place of the actual centre of administration of this person, if this is different from its registered office and the institution is, in any way, aware of this situation.

(5) For exposures to CIUs, it is appropriate that they are deemed located in the place of the obligor of the underlying exposure. Is the definition of the obligor of the underlying exposure unreasonably burdesome, the exposure to the CIU may be allocated to the place of the institution.

(6) Exposures to non-credit-obligation assets are to be allocated to the place of the institution, as in most of these cases the obligor cannot be identified.

(7) Proportionality and materiality considerations are taken into account for institutions with limited foreign overall exposure or limited trading book activity, by allowing simpler allocation methods for these institutions. This is intended to alleviate the burden for smaller institutions which tend to have limited foreign and trading activity.

(8) When determining the overall exposure to a certain obligor in respect of transactions with underlying assets, institutions should have in mind the framework established by the Regulatory Technical Standards under Article 390(8) of Regulation (EU) No 575/2013.

(9) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.

(10) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, it has analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

Article 1

Definitions

1. 'credit exposure' means the risk weighted exposure amount referred to in Article 140(4)(a) of Directive 2013/36/EU;
2. 'trading book exposure' means the risk weighted exposure amount referred to in Article 140 (4)(b) of Directive 2013/36/EU;
3. 'securitisation exposure' means the risk weighted exposure amount referred to in Article 140(4)(c) of Directive 2013/36/EU;
4. 'place of the obligor' means the country where the natural or legal person, who is the institution's counterparty to a credit exposure or the issuer of the financial instrument not included in the trading book or the counterparty to a non-trading book exposure, is ordinarily resident (in the case of a natural person), or has its registered office, or its actual centre of administration if that is in a different country from its registered office (in the case of a legal person);
5. 'place of the debtor' means the country where the natural or legal person who is the issuer of the financial instrument in the trading book, or the counterparty to a trading book exposure, is ordinarily resident (in the case of a natural person), or has its registered office, or its actual centre of administration if that is in a different country from its registered office (in the case of a legal person);
6. 'place of the institution' means the Member State in which the institution has been granted authorisation;
7. 'place of the income' means the country of the location of the assets, which generate the income that is the primary source of repayment of the obligation in relation to a specialised lending exposure;
8. 'foreign exposure' means a credit exposure which is not a domestic exposure;

9. ‘domestic exposure’ means a credit exposure whose place of obligor or place of debtor coincides with the place of the institution;
10. ‘specialised lending exposure’ means credit exposures possessing the characteristics referred to in Article 147(8) of Regulation(EU) 575/2013.

Article 2

Credit Exposures

1. For the purpose of calculating the institution-specific countercyclical capital buffer rates, institutions shall identify the geographical location of their credit exposures in accordance with this Article.
2. Exposures to CIUs as referred to in point (o) of Article 112 of Regulation (EU) No 575/2013, shall be deemed to be located in the place of the obligor(s) of the underlying exposures. If there is more than one location corresponding to the obligors of the underlying exposures of a given CIU exposure, the equivalent treatment applied to securitisation exposures in Article 4(3) may also be used for CIU exposures.
3. Credit exposures as referred to in Article 147(8) of Regulation (EU) No 575/2013 shall be deemed to be located in the place of the income.
4. Exposures to other items as referred to in point (q) of Article 112 of Regulation (EU) No 575/2013 shall be deemed to be located in the place of the institution, if these exposures qualify as non-credit-obligation assets and the institution cannot identify their obligor.
5. All other credit exposures, which do not fall under paragraphs 2 to 4, shall be deemed to be located in the place of the obligor.
6. Notwithstanding paragraphs 2 and 5, the following exposures may be allocated to the place of the institution:
    a. Exposures to CIUs as referred to in point (o) of Article 112 of Regulation (EU) No 575/2013, if the institution cannot identify the place of the obligor(s) of the underlying exposures based on information existing internally or available externally without disproportionate effort.
    b. Foreign exposures, whose aggregate credit exposure does not exceed 2% of the aggregate of the credit, trading book and securitization exposures of that institution. The aggregate of the credit, trading book and securitization exposures is calculated by excluding the credit exposures located in accordance with paragraphs 4 and 6(a) of this Article.
7. Institutions shall calculate the percentage referred to in (b) of the previous paragraph, both on an annual and on an ad hoc basis. An ad hoc calculation is required when an event that affects its financial or economic situation occurs.

Article 3

Trading book exposures

1. For the purpose of calculating the institution-specific countercyclical capital buffer rates, institutions shall identify the geographical location of their trading book exposures in accordance with this Article.
2. Subject to paragraphs 3 and 4, trading book exposures shall be deemed to be located in the place of the debtor.
3. For trading book exposures subject to the own funds requirements under Part Three, Title IV, Chapter 5 of Regulation (EU) No 575/2013, institutions shall determine the geographical location of these exposures by multiplying the total risk-weighted exposure amount for these exposures by the ratio of (a) to (b) below:
   (a) the own funds requirements for sub-portfolios split according to the geographical location determined according to the model of Part Three, Title IV, Chapter 5 of Regulation (EU) No 575/2013;
   (b) the sum of own funds requirements determined under point (a) across all geographical locations.
4. Notwithstanding paragraphs 2 and 3 of this Article, institutions, whose total trading book risk-weighted exposure amount does not exceed 2% of their total credit, trading book and securitisation exposures, may allocate these exposures to the place of the institution.
5. Institutions shall calculate the percentage referred to in the previous paragraph, both on an annual and on an ad hoc basis. An ad hoc calculation is required when an event that affects its financial or economic situation occurs.

Article 4

Securitisation exposures

1. To calculate the institution-specific countercyclical capital buffer rates, institutions shall identify the geographical location of their securitisation exposures in accordance with this Article.
2. A securitisation exposure shall be deemed to be located in the place of the obligor(s) of the underlying exposures.
3. Notwithstanding paragraph 2 of this Article, if there is more than one location corresponding to the obligor of the underlying exposures of a given securitisation exposure, that exposure may be deemed to be located at the place of the obligor of the underlying exposures with the highest proportion in the underlying securitisation exposures.
4. Notwithstanding paragraphs 2 and 3 of this Article, securitisation exposures for which information on underlying securitisation exposures are not available, may be allocated to the place of the institution if the institution cannot identify the underlying obligor based on existing available information from internal or external sources or without applying a disproportionate effort to obtain the information.

Article 5

Final provisions

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

4. Accompanying documents

4.1 Draft cost-benefit analysis / impact assessment

1. Article 10(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any draft regulatory technical standards developed by the EBA are submitted to the Commission for adoption, they shall be accompanied by an analysis of 'the potential related costs and benefits'. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

2. The analysis of these draft RTS on the method for identifying the geographical location of the relevant credit exposures is provided in this section. These draft RTS have been developed pursuant to Article 140(7) CRD.

Problem definition

Issues addressed by the European Commission regarding pro-cyclicality

3. In the impact assessment accompanying its proposal for the CRD[3], the Commission noted that the non-responsiveness of regulatory capital requirements to the build-up of risk at the macro level had led to an accumulation of financial imbalances before the most recent financial crisis. These imbalances, once the economic cycle turned, prompted a deleveraging spiral and precipitated steep credit-related losses.

4. In line with Basel III, the Commission proposed in CRD IV a countercyclical buffer that would take account of the macro-financial environment in which institutions operate. National authorities should set the buffer for credit exposures in their jurisdiction. The buffer should not generally exceed 2.5% of the risk-weighted assets of an institution and would only be imposed when there was evidence that the excess credit growth was resulting in a build-up of system-wide risk. Institutions with exclusively domestic credit exposures would only be subject to the buffer determined by their national supervisors.

Issues addressed by these RTS and objectives

5. Institutions with exposures in other jurisdictions will have to determine the rate to apply for their countercyclical buffer by calculating the weighted average of the countercyclical buffer rates that apply in the jurisdictions where these relevant credit exposures are located. In practice, this means that cross-border credit institutions would have to look at the geographical location of their credit exposures and calculate their countercyclical capital buffer according to the buffers prevailing in those Member States where their exposures are located. To promote consistency in the method used to calculate the countercyclical buffer, the Commission mandated the EBA to define a method for identifying the geographical location of the credit exposures.

[3] Impact assessment accompanying the document Regulation of the European Parliament and the Council on prudential requirements for the credit institutions and investment firms pp.12-13.

6. These RTS will contribute to a common understanding among institutions and the EU's national competent authorities about the methodology that institutions should use to identify the geographical location of their exposures. It will also ensure a minimum level of harmonisation and consistent practice in this area and contribute to achieving the objectives in the CRD of reducing the cyclicality of provisioning and capital requirements.

Technical options considered

7. This section explains the rationale behind some of the choices that the EBA has made in drafting these RTS.

Determining the location of the credit risk exposures

8. Initially, the EBA considered two possible locations to which an exposure could be allocated:

- Option A1 - The country where the obligor resides;
- Option A2 – The country where the obligor resides, or, if there is a guarantor, (i) where the guarantor resides, or, ultimately, (ii) where the collateral is held.

9. Using data from the consolidated statistics of the Bank for International Settlements (BIS) , which capture the consolidated positions of institutions' worldwide offices[4], the EBA has tried to determine:

   a. the volume of foreign claims booked by EU institutions and specialised lending, in particular relatively to the total assets;

   b. how the different methods proposed for the geographical location of a claim may affect the size of the countercyclical buffer to be held.

10. **Significance of foreign claims –** In the six countries for which data was available, foreign claims in Q4 2012 were USD 11.8tn, of which around USD 7tn (58% of total foreign claims) were granted to counterparties in the non-bank private sector (which includes non-bank financial institutions and non-financial private sector). The share of non-bank private sector foreign claims was between 51% and 72% of total foreign claims granted by domestic institutions. Total foreign claims represented between 17.2% and 32.4% of the total assets held by domestic institutions in each of the six countries. Non-bank private sector foreign claims accounted for between 8.8% and 22.5% of the total assets held by institutions.

11. Between 2005 and 2010, total foreign claims booked by banks to counterparties in foreign countries varied significantly. In most of the six countries under consideration, total foreign claims doubled between 2005 and 2008, fell by 30%-50% during the period 2008-2010, and have been

[4] Granular data on foreign claims on an ultimate risk basis (URB) is only available at a country level for six EU countries: Belgium, France, Germany, Italy, Spain and United Kingdom. The data available for intermediate basis (IB) is aggregated for all BIS reporting countries and is not available at country level.

mostly stable since 2010. For all the countries in the sample except the UK, more than 50% of the foreign claims were booked with a counterparty located in the EU28.

12. **Significance of specialised lending –** Project financing represents only a small fraction of the loans granted to non-financial institutions and is likely to be only slightly affected by these RTS. According to Dealogic[5]**,** the worldwide project finance total was USD 172.0bn in the first half 2012 and around 22.5% was done in Europe[6] (USD 38.6bn). Using data from the ECB[7], the EBA estimated that project financing represented between 0.5% and 1.1% of the total loans granted to non-financial institutions in 2011. This includes both domestic and foreign claims so the share of project financing granted to foreign entities as a proportion of all loans granted is likely to be even smaller.

13. **Impact of the different methods of allocating foreign claims –** The EBA has examined the differences in exposures under the immediate obligor principle (i.e. when claims are allocated to the country of residence of the immediate counterparty (option A1)) and those allocated under the guarantor/collateral principle (where the 'ultimate risk' lies (option A2)). For foreign claims measured on an intermediary basis, the data available is aggregated across all countries reporting to the BIS[8], and no data is available at a reporting country level. However, the exposure of all institutions reporting to the BIS to all counterparties in any given country is available.

14. A number of important caveats associated with the data in this report must be highlighted. First, the breakdown by sector is not available and therefore it was not possible to compare exposure for the non-banking sector only, which is the type of exposure specifically affected by these RTS. Then, the set of institutions reporting data on an immediate borrower basis is composed by domestic banks on a consolidated basis and non-domestic resident banks, whereas that reporting data on an ultimate risk basis (or guarantor basis) includes only resident banks. The difference between the two populations of reporting banks reduces the comparability between the two measures of foreign claims. With these caveats in mind, the absolute and relative difference between the foreign claims that each of countries of the EU28 had towards all the BIS reporting countries was calculated from 2005 to 2012.

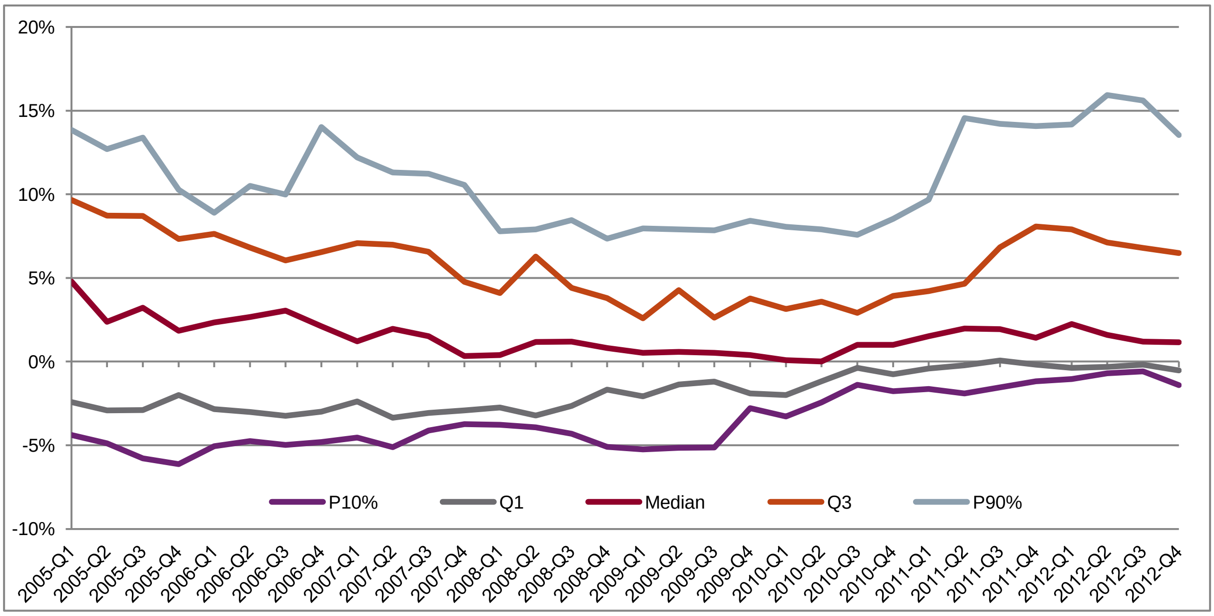
15. Figures 1 and 2 present some summary statistics of the results of this calculation. During this period, taking 22 of the 28 countries, foreign claims measured using intermediary basis were 6% lower than exposures measured according ultimate risk basis for the country with the highest negative difference and 16% higher for the country with the highest positive difference. In absolute terms, taking 22 of the 28 countries, foreign claims measured using the intermediary basis were USD 37bn lower than measured using the ultimate risk basis for the country with the highest negative difference, and USD 3bn higher for the country with the highest positive difference. For the outliers (not shown in the graph), the absolute differences reached extremes of USD 440bn and -USD 369bn before 2009, and after this date, USD 139bn and -USD 247bn. In relative terms,

[5] Dealogic Project Finance Review - 1H 2012.
[6] Europe covers here all European countries including Russia.
[7] ECB Statistical Data Warehouse - Loans to non-financial corporations
[8] The countries for which foreign claim data is available after 2005, both for ultimate risk and intermediary basis are the following: Australia, Austria, Belgium, Canada, Chile, Chinese, Taipei, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

the largest difference during the whole period was 29% for the highest positive difference and 15% for the highest negative difference.

16. From this analysis, for most exposures to a member of the EU28, using one either geographical location option will only have a modest impact on the volume of exposures which are allocated to each foreign country and therefore on the size of the countercyclical buffer. This result should be taken with caution, as it has not been possible to identify to which extent some of the differences between the two measures of foreign claims may be explained (or compensated) by the difference of reporting population from the data used (domestic and non-domestic for immediate risk basis and only domestic for ultimate risk basis).

Figure 1 – Relative difference between foreign claims held by banks from all BIS reporting countries towards an EU28 Member State from 2005 to 2012 (in %)



17. In light of these results, the EBA favours option A1, the country of residence of the obligor for geographical location of exposures. The role of the CCB is to protect banks from the build-up of system-wide vulnerabilities, by creating buffers in boom times (when risks are taken on but, arguably, are not fully reflected in prices) and by releasing them in bad times (when the market price of risk shoots up as losses materialise). With that objective in mind, it seems more appropriate to link the geographical location to the residence of the obligor, which is closely linked to the economy that, in most cases, is relevant for the buffer.

18. The EBA agrees that in some cases (for instance in project financing) the guarantor plays such an important role that the economic environment (thus, geographical location) of the guarantor or collateral would be a better reference for the purposes of the CCB. Therefore, for specialised lending exposures, the EBA favours option A2, i.e. the country where the obligor resides, or, if there is collateral or a guarantor, the country where the guarantor or collateral resides.

Impact of the proposals

Costs

19. There will be direct compliance costs for identifying the geographical location of the exposures according to the methodology proposed. Institutions may have parts of this information available already for COREP reporting, although the use of any principle, be it source of income, guarantor principle or obligor principle may impose implementation costs for institutions. It is to be expected that institutions will have the information on the obligor available, although it is recognised that the information may not be readily available in reporting systems.

20. The implementation of these RTS may have additional resource implications for national supervisory authorities (NSAs), in terms of additional staff time required for supervision. However, these additional resources should not be significant, as NSAs should already be monitoring the compliance of institutions with EU capital requirements.

Benefits

21. By establishing harmonised practices for the geographical location of exposures, these RTS will ensure that institutions in different Member States use the same methodology when calculating their countercyclical buffer, providing legal clarity and a level playing field, as well as facilitating the CCB calculation by cross-border institutions.

4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for three months and ended on 1 November 2013. A total of ten responses were received, of which nine were published on the EBA website.

This paper presents a summary of the key points and other comments from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them, if deemed necessary.

In many cases, several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In these cases, the comments and EBA analysis are included in the section of this paper where the EBA considers them most appropriate.

Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
Institutions with limited credit, trading book and securitisation exposures	One respondent correctly notes that as the institution-specific countercyclical has to be applied to the total risk exposure amount, specialised institutions with substantial exposures to sovereigns and institutions may have very limited exposures as defined in article 140 (4)(a)-(c) and the geographical distribution may therefore be misleading.	The EBA agrees that this issue may arise. However, given that this issue arises as a consequence of the mandate in article 140, it is not possible for the EBA to rectify this issue through these RTS.	No change to these RTS.
Alignment with COREP reporting requirements	It is noted by several respondents, that documentation in COREP should be updated to reflect the content of these RTS.	The EBA agrees that the reporting framework in COREP should be aligned with the definitions used in these RTS. Consequently after adoption of this technical standard by the Commission, the EBA will initiate an update to the COREP documentation to fully reflect this.	No change to these RTS.
Clarification of what are the relevant credit	It should be clarified that the geographical location of equity exposures should also be		No change to these RTS. It is clear in the text that for equity exposures in the

exposures for the calculation of the CCB rate	determined.		banking book, the principles of Article 2 apply, whereas for equity exposure in the trading book, the principles of Article 3 apply. It is added to Article 2 that exposures where no obligor can be identified, such as non-credit-obligation assets and exposures to CIUs, may be allocated to the place of the institution.
Inconsistency between Article 1 and Articles 2 and 3 regarding the terminology exposure or risk weighted exposure	One respondent noted inconsistency in the terminology of exposures versus risk weighted exposures. Article 1 mentioned credit exposure without referring to any risk weight, whereas Articles 2 and 3 refer to risk weighted exposures. The respondent also noted that the definition of foreign exposure in Article 1 should be consistent with the terminology in Article 2 (foreign credit exposure)	The EBA agrees that there was inconsistency between Article 1 on the one hand, and Articles 2 and 3 on the other. However, the specifications in Art 140(4)(a) CRD, state that relevant credit exposures are the own funds requirements for credit risk, the trading book or securitisations. Hence, it is clear that the relevant credit exposures are the risk weighted exposures.	The legal text has been changed to ensure consistency. More specifically, Article 1, paragraphs 1-3 now define each of the credit, trading book and securitisation exposures to be risk weighted exposure amounts.
Geographical location of the institution: legal address (headquarter) or country of operations	One respondent noted that these RTS should specify how the geographical location of a branch should be determined. Two options were suggested: the legal address (i.e. the location of the headquarter) or the country of operations. The respondent is in favour of the legal address, i.e. the location of the headquarters.	The EBA would like to mention that the draft CP already clarifies the geographical location, in recital 4 (exposures of an institution to a legal person), and Article 1, paragraphs 4 (definition of place of the obligor) and 5 (definition of place of the debtor).	No change to these RTS.

Responses to questions in Consultation Paper EBA/CP/2013/35			
Q1. Do you agree with using the obligor principle for the practical implementation of the CCB? If not, could you provide specific examples where this principle would not work in practice and explain why an alternative option would work better?	Substantial disagreement appears to exist among respondents on the appropriate approach for allocating credit exposures. Some fully agree with the proposal at hand, whereas others believe the Credit Risk Mitigation framework should be taken into account, i.e. take into account the use of collateral. Finally, a respondent noted the need to use the source of income more broadly than just for specialised lending, i.e. use the country where a customer generates his income.	The obligor principle has been retained.	No change to these RTS.
Q2. Do you agree with using the guarantor principle for specialised lending?	A respondent noted that the use of the source of income would be in contradiction with the argumentation for the use of the obligor, namely that the credit-to-GDP gap will be based on the obligor principle. It would therefore be appropriate to use the obligor principle consistently. Furthermore, bearing in mind the low proportion of specialised lending exposures, the departure of the use of the obligor principle would not have a meaningful impact on the project financing sector.	The principle has been maintained.	No change to these RTS.

	Other respondents supported this view, noting that the approach may be too prescriptive and that a simpler approach should be applied. Other respondents on the contrary note the appropriateness of this approach.		
Q3. Should other exposures, such as residential or commercial mortgages, also use the guarantor principle? If yes, please justify the answer.	There appears to be some disagreement on this topic among the respondents. Some feel that the obligor principle should generally be used, whereas others believe, as explained above in the answers given to Q1, that for a number of exposures, the guarantee principle appears more appropriate.	The EBA believes, in line with the use of the obligor principle, that this approach should generally be used.	No change to these RTS.
Q4. Do you agree with the inclusion of a threshold for credit risk exposures? Would this threshold lead to any substantial reduction in the burden for institutions?	All respondents welcomed a proportionality threshold. However some respondents noted that the 2% threshold appears to be low and propose increasing it. A respondent proposed lowering it to 0.5% on a country basis, but to include a 10% overall threshold. Some respondents noted that the operational burden with a low threshold may be higher, if this needs to be	The EBA has maintained the proportionality threshold at 2%, as a higher threshold may impact on host countries' ability to conduct macro-prudential policies, as large institutions operating in a host country may risk being below a higher threshold and therefore may not be subject to the countercyclical buffer in the host country. Some arguments can be made in favour of lowering the threshold to 0.5% on a	Changes have been introduced to reflect the re-calculation frequency, the possibility to use a 0% threshold and other clarifications.

	additionally checked. Consequently, they proposed that the threshold may be lowered to 0% by the institution. Additionally, clarification is asked on how the calculation of the threshold is to be performed, which includes a request to clarify the re-calculation frequency.	country basis with a 10% backstop. However given the support of other respondents to the 2% threshold, this has been maintained. As regards the possibility of lowering the threshold to 0%, these RTS has been re-worded to allow for this. Similarly additional clarification has been provided on the calculation of the threshold, as at least an annual calculation will need to be done on this threshold. However, institutions are required to perform the threshold calculation, if they have a reasonable expectation that conditions have changed, for instance by the purchasing of new lending portfolios, mergers, the opening of foreign branches/subsidiaries and other such activities.	
Q5. Do you agree with approach chosen and is the approach sufficiently clear? If not, please describe the best method for allocating the total specific and IRC	The approach for adopting the standardised approach for specific risk for institutions also using advanced approaches was questioned by the respondents of the consultation. A respondent was in agreement with the proposal, but most considered the approach difficult and felt it would lead to parallel processes.	The EBA agrees with the industry proposal of allowing the use of the IRC model to calculate geographical exposures, as this avoids parallel processes and appears the least operationally burdensome approach. The EBA believes that the use of the	These RTS has been amended such that institutions calculating the own funds requirements of their trading book exposures using internal models, can determine the geographical location by running the IRC models on a country-by-country basis.

capital charges and describe its rationale and practical implementation.	Furthermore it would not take into account short positions, which could substantially skew the actual distributions. The EBA proposed four alternatives, of which gained some support from a few respondents, namely the allocation according to the credit exposures. This is, however, generally considered to be a very risk-insensitive measure, especially for those institutions having significant exposures. In addition, two alternatives were suggested by respondents. The first proposal notes that the IRC calculation can be done on a country-by-country basis, which would allow for an identification of geographical exposures under the IRC approach. The approach proposed would do the following: a. Run the IRC model with relevant exposures (i.e. excluding exposures to Sovereigns and Institutions) to calculate the capital charge. b. Re-run the model with exposures for each country in isolation to calculate a country specific charge.	same distribution for credit exposures may be appropriate for institutions having limited trading book exposures. However, for institutions having higher levels of trading book exposures, the approach appears to risk-insensitive. The second proposed approach concerns a stress test approach, which would stress the geographical exposures one-by-one and the losses would be used to determine the allocation. Whilst having some intuitive appeal, given that there is a need to capture those exposures that would suffer most during a down-turn, it appears to be operationally difficult, as stress test scenarios would have to be detailed. The analysis would make such an analysis complex. The problems with making this approach operational therefore appear to outweigh the advantages.	

	c. Allocate the country-specific charge relative to the sum of individual country-specific charges. The second approach is to base the allocation on a stress test approach, where institutions are asked to calculate losses under various scenarios. The losses would then be used to determine the geographical distribution.		
Q6. Do you agree with the inclusion of a proportionality threshold for trading book exposures?	The respondents agree with the introduction of a proportionality threshold for trading book exposures, although some respondents prefer a higher threshold. In addition, it is noted that there is some uncertainty about the calculation of the threshold, as the threshold can refer both to overall trading book exposures, or only the market risk exposures associated with specific risk, incremental default and migration risk. The EBA should also consider excluding run-off portfolios.	The EBA believes the threshold is appropriately set, as the purpose of the proportionality threshold is to simplify the implementation of these RTS for institutions having limited trading book activity – the 2% threshold appropriately reflects this. The proportionality threshold should not exclude institutions regularly engaging in trading book activities. The EBA agrees that the threshold applies only to the exposures specified in article 140 4(b) and this has been clarified in these draft RTS. As regards the exclusion of run-off portfolios, this is considered outside the scope of these RTS.	It is clarified in these RTS that the calculation of the threshold applies only to the exposures specified in article 140 4(b).

Q7. Do you agree with the application of a look-through approach for securitisation exposures? Can the approach proposed be implemented for re-securitisation exposures? Should other exposures such as CIUs also use the look-trough approach? If yes, please justify the answer.	The respondents note that the look-through approach for securitisation exposures is appropriate. One respondent noted that a differentiation should be made between securitisations initiated by the institution, and securitisations purchased by the institution. With regard to the former, the respondent did not agree with the look-through approach in cases where the securitisation has passed the significant risk transfer test. The respondent agrees to the use of the look-through approach for securitisations purchased by the institution. As regards CIUs, respondents noted that this would be very burdensome and the investment required to comply with this requirement would be substantial and would outweigh the benefits. Regarding CIUs, one respondent noted the determination of the geographical location of CIU exposures should be in line with Art 132(4) and (5) CRR, which differentiates between cases where the institution is aware of the underlying exposures of the CIU, and cases where it is not.	The EBA agrees that these RTS should specify how the geographical location of exposures to CIUs should be dealt with. However, it is decided not to adopt the look-through approach for CIU exposures. Instead, these exposures shall be allocated to the place of the obligor of the main underlying exposure(s). Furthermore, a fall-back option is foreseen in case this information cannot be obtained.	The geographical location of CIU exposures is now specified in Article 2. CIU exposures shall be allocated to the location of the main underlying obligor, as specified in paragraph 2 of Article 2. However, if no main obligor can be easily determined, the institution may decide to allocate these CIU exposure(s) to the place of the institution. This choice is in line with Art 132 (4) and (5) CRR, where a differentiation is struck between cases where an institution is aware of the underlying exposures of a CIU (paragraph 4 of Art 132 CRR), and cases where it is not (paragraph 5 of Art 132 CRR). It is decided not to differentiate between securitisation positions originated, versus purchased, and securitisation positions that passed the significant risk transfer test, because this would complicate the calculations, and this would not meaningfully affect the calculated countercyclical capital buffer.

	As regards re-securitisations originated by the institution, one respondent also suggested exempting re-securitisation exposures that pass the significant risk transfer test from the look-through approach.		
Q8. Do you agree that the geographical location of exposures should be the location having the highest proportion of the underlying exposures? Would it be difficult to locate all underlying exposures geographically?	Respondents agree with this proposal for securitisations purchased, although it is noted that for some legacy portfolios a fall back approach should be available.	The EBA agrees with the comment.	These RTS have been changed and now include a fall back option, such that institutions may allocate securitisation exposures to the place of the institution, if information on underlying exposures is not available, or can only be obtained with a disproportionate effort.
Q9: Do you agree with our analysis of the impact of the proposals in this consultation paper? If not, can you provide any evidence or data that might further assist our analysis of	A respondent noted that the COREP will provide some of the data, although not in the granularity required for the buffer calculation. It is considered, therefore, that there will be significant costs in making the requirements operational. Another respondent highlighted the weaknesses in using the BIS data, whilst	The EBA notes that institutions do not agree that the relevant information is available in COREP templates. Nonetheless, the information on the obligor should be available to institutions as part of its normal credit management procedures, although it is recognised that implementation costs may exist in incorporating this information in reporting	Change on the availability of data on the obligor included in the impact assessment.

the possible impact of the proposals?	recognising that since limited data is available, the use of data is the only possibility. Given the limited differences between the obligor and the guarantee principle, the use of the obligor principle appears to be justified. Finally, it is noted by a third respondent, that an overly prescriptive approach may make the calculation very costly.	systems.	