EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

REGULATION AND PRUDENTIAL SUPERVISION OF FINANCIAL INSTITUTIONS
Bank regulation and supervision

PUBLIC CONSULTATION DOCUMENT

IMPLEMENTING THE FINAL BASEL III REFORMS IN THE EU

Disclaimer

This document is a working document of the Commission services for consultation and does not prejudge the final decision that the Commission may take.

The responses to this consultation paper will provide important guidance to the Commission when preparing, if considered appropriate, a formal Commission proposal.

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https://ec.europa.eu/info/business-economy-euro_en

You are invited to reply to the **online questionnaire** available on the following webpage: https://ec.europa.eu/info/publications/finance-consultations-2019-basel-3_en

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses**.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published unless respondents indicate otherwise in the online questionnaire.

Responses authorised for publication will be published on the following webpage: https://ec.europa.eu/info/publications/finance-consultations-2019-basel-3_en

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INTRODUCTION

The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. The full set of the standards agreed by the BCBS is known as the "Basel framework". The standards set out a system based on three "pillars":

- minimum capital and liquidity requirements (referred to as "Pillar 1");
- a supervisory review process aimed at ensuring that banks have adequate capital and liquidity to support all the risks in their business but also to encourage banks to develop and use better risk management techniques in monitoring and managing their risks ("Pillar 2");
- disclosure requirements that seek to provide market participants with sufficient information to assess a bank's material risks and capital adequacy and thus to encourage market discipline by banks ("Pillar 3").

The original set of standards ("Basel I framework")[1] was agreed in 1988 and was first reviewed in 2004 ("Basel II framework")[2]. In response to the 2008 financial crisis, the BCBS reviewed its standards for a second time with the overarching goal to provide a regulatory foundation for a resilient banking system that supports the real economy. The result of this review, the final elements of which have been published by the BCBS at the beginning of this year, is the so-called "Basel III framework".

The standards agreed by the BCBS are not directly applicable and need to be implemented by each member jurisdiction. In the EU, those standards are implemented through the Capital Requirements Regulation (CRR)[3] and Directive (CRD)[4] which introduced a single rulebook comprising prudential requirements applicable to "institutions"[5]. Large parts of the Basel III framework have already been implemented through legislative packages known as "CRR/CRD4"[6] and "CRR2/CRD5"[7]. With some exceptions, the elements of the Basel III

[1] "International convergence of capital measurement and capital standards", available at: https://www.bis.org/publ/bcbs04a.pdf.

[2] "International Convergence of Capital Measurement and Capital Standards – A Revised Framework Comprehensive Version", available at: https://www.bis.org/publ/bcbs128.pdf.

[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 Text with EEA relevance, OJ L 176, 27.6.2013, p. 1–337.

[4] 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.

[5] The CRR and CRD do not apply to "credit institutions" (banks) but also to "investment firms" which are collectively referred to "institutions".

[6] See https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/prudential-requirements_en.

[7] See https://europa.eu/rapid/press-release_MEMO-19-2129_en.pdf.

framework that were completed by the BCBS between the end of 2017 and the beginning of 2019 have yet to be implemented in EU law.

In particular, in December 2017 the BCBS finalised its Basel III reforms with revisions to the prudential standards for credit, operational and credit valuation adjustment (CVA) risk as well as the replacement of the so-called "Basel I floor" with an aggregate output floor.[8] Revisions to "Pillar 1" of the Basel framework mainly seek to increase the risk-sensitivity and robustness of the standardised approaches to calculate own funds requirements for abovementioned risks and to improve the comparability of capital ratios of institutions using internal models. They have been accompanied by updated Pillar 3 disclosure requirements, which the BCBS published in December 2018.[9] Further to this work, in January 2019 the BCBS published a revised version of its market risk standard known as 'fundamental review of the trading book' (FRTB)[10] that had originally been published in January 2016.

BCBS members agreed to full, timely and consistent implementation of all elements of the reform package by 1 January 2022 as the main implementation deadline, with some revisions including the output floor to be phased-in until 1 January 2027. The Commission is committed to this agreement and its faithful implementation in the EU, taking into account European specificities and the objective stated by co-legislators for the reforms not to result in a significant increase in the overall capital requirements for the banking sector[11].

Over the last year the Commission services have been preparing the grounds for the implementation of the Basel III standards in the EU, which would require amendments to the CRR and the CRD. As a first preparatory step, the Commission services conducted an exploratory public consultation in spring 2018. Based on the numerous responses received from stakeholders, the Commission services sent a comprehensive Call for technical Advice (CfA)[12] to the European Banking Authority (EBA) in May 2018, inviting the EBA to assess i) the potential impact of the various elements of the reform package on the EU banking sector and the wider economy including possible effects on the relative attractiveness of certain activities or business models, and ii) possible implementation challenges.

The EBA submitted its cumulative impact assessment and advice in the areas of credit risk, operational risk, output floor and securities financing transactions (SFTs) on 5 August 2019.[13] The EBA is expected to publish findings in the area of market risk and CVA risk later in 2019 due to the later completion of these parts of the Basel III framework.

Based on the impact estimates available to date, the technical advice of the EBA and feedback received from stakeholders so far, a number of topics has emerged on which the Commission services would particularly welcome views and relevant evidence (preferably quantitative) in order to inform its decision-making on the EU implementation of the outstanding Basel III reforms.

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[8] "Basel III: Finalising post-crisis reforms", available at: https://www.bis.org/bcbs/publ/d424.pdf.

[9] "Pillar 3 disclosure requirements – updated framework", available at https://www.bis.org/bcbs/publ/d455.pdf.

[10] "Minimum capital requirements for market risk", available at: https://www.bis.org/bcbs/publ/d457.pdf.

[11] See http://data.consilium.europa.eu/doc/document/ST-10959-2016-INIT/en/pdf, and http://www.europarl.europa.eu/doceo/document/TA-8-2016-0439_EN.html?redirect.

[12] "Call for advice to the EBA for the purposes of revising the own fund requirements for credit, operational, market and credit valuation adjustment risk", available at: https://eba.europa.eu/documents/10180/2207145/Letter+from+Olivier+Guersent+on+the+CfA+the+purposes+of+revising+the+own+fund+requirements+for+credit%2C%20operational+market+%26+credit+valuation+adjustment+risk+040518.pdf/cf34493f-7ef7-4d07-a382-6a07b331103b.

[13] "EBA advises the European Commission on the implementation of the final Basel III framework", available at: https://eba.europa.eu/-/eba-advises-the-european-commission-on-the-implementation-of-the-final-basel-iii-framework.

Beyond these implementation topics, the Commission services would welcome stakeholders' views on three other subjects:

- a possible centralisation of Pillar 3 disclosures at the level of EBA who could relieve institutions from their respective duties by providing the required information to the market on the basis of the supervisory data collected in the context of the forthcoming European Centralised Infrastructure for Supervisory Data (EUCLID);
- whether further measures, if any, could be taken to incorporate environmental, social and governance (ESG) risks into prudential regulation without pre-empting ongoing work to this effect; and
- possible changes to the existing regime for the assessment of the suitability of members of the management body of financial institutions ("fit and proper"), as it has become apparent that practices for assessing members of the management body, and also other individuals who can play a critical role in decision making, vary significantly across Member States.

The selected topics are presented in this consultation document, which is organised in nine main sections discussing possible changes in the areas of:

1. Credit risk
2. SFTs
3. Operational risk
4. Market risk
5. CVA risk
6. Output floor
7. Centralised supervisory reporting and disclosures
8. Sustainable finance
9. Fit and proper

The sections contain specific questions on each of the selected topics. Due to the nature of the topics, most of the questions are technical.

This consultation is open to all citizens. Feedback is sought, in particular, from the following "key stakeholders": institutions, banking associations and other financial services providers, bank clients, consumer representatives as well as public authorities, including supervisors.

This public consultation and the EBA's advice will feed into the Commission's impact assessment.

1. Credit risk

1.1. Standardised Approach (SA-CR)

1.1.1. General issues

1.1.1.1. External credit risk assessment approach (ECRA) vs. standardised credit risk assessment approach (SCRA)

Issue: The Basel III standards retain the use of external ratings for exposures to sovereigns, public sector entities (PSEs), multilateral development banks (MDBs), institutions, covered bonds and corporates (termed ECRA) under the standardised approach for credit risk, with alternative approaches for unrated exposures to institutions (see 1.1.3.1.) and also for exposures to covered bonds and corporates in jurisdictions that do not allow the use of external ratings for regulatory purposes (termed SCRA).
In the EU, the use of external credit ratings is currently allowed and widespread practice for determining the applicable risk weights (RWs) for all of the abovementioned exposure classes in accordance with the CRR which implements the Basel II standards. The adequacy of the credit ratings issued by credit rating agencies for regulatory purposes is subject to continuous monitoring by the EBA in cooperation with the other European Supervisory Authorities.

Questions:

1) Views are sought on the relative costs and benefits of the ECRA provided by the final Basel III standards and the SCRA? In particular, how do the two approaches compare in terms of risk-sensitivity, impact on risk-weighted assets (RWAs) and operational burden? Please specify the relative costs and benefits of the two approaches for exposures to i) institutions, ii) covered bonds and iii) corporates. Please provide relevant evidence to substantiate your views.
2) Would you deem refinements or clarifications necessary concerning the approach that you generally prefer, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

1.1.1.2. Enhanced due diligence requirements

Issue: The Basel III standards contain some clarifications in relation to the due diligence to be performed by institutions "*to ensure that they have an adequate understanding, at origination and thereafter on a regular basis (at least annually), of the risk profile and characteristics of their counterparties*" (paragraph 4).[14] In cases where ratings are used (except for exposures to sovereigns and PSEs), due diligence is considered necessary "*to assess the risk of the exposure for risk management purposes and whether the risk weight applied is appropriate and prudent*" (paragraph 4). If the due diligence analysis reflects higher risk characteristics than those implied

[14] More specifically, institutions are required to "*take reasonable and adequate steps to assess the operating and financial performance levels and trends through internal credit analysis and/or other analytics outsourced to a third party, as appropriate for each counterparty*". Moreover, institutions "*must be able to access information about their counterparties on a regular basis to complete due diligence analyses*" (ibidem).

by the external rating bucket of the exposure, a RW at least one bucket higher than the "base" RW determined by the external rating must be assigned.
The CRD already imposes in Article 79 due diligence requirements in relation to institutions' risk management processes to prevent mechanistic reliance on external credit ratings. However, the current EU legislation does not explicitly require institutions to analyse whether the RWs implied by the external ratings are appropriate and prudent for a given exposure and to apply a higher RW accordingly.

Questions:

3) Views are sought on the costs and benefits of implementing the various clarifications and specifications provided by the Basel III standards (paragraph 4) in relation to the due diligence to be performed by institutions. Please provide specific answers on each of the clarifications/specifications and support your view with relevant evidence.
4) If you are of the view that the CRR/D should be amended to clarify/specify the rules on due diligence requirements, what would constitute an appropriate approach in your view? Please specify and provide relevant evidence.
5) In your view, should the due-diligence requirements differentiate between exposures for which a rating exists and unrated exposures treated under the SCRA (see above 1.1.1.1.), and if so, why? Please elaborate and provide relevant evidence.

1.1.2. Exposures to institutions

1.1.2.1. Definition of grades under the SCRA

Issue: The Basel III standards apply the SCRA to all exposures to unrated institutions, which are to be classified into one of three grades. For this classification, the standards lay down quantitative and qualitative criteria (see paragraphs 22-29) with the aim to increase the granularity and risk-sensitivity of the standardised approach to credit risk (SA-CR).

Quantitative criteria:

- *Grade A*, attracting the lowest RW, would be available to counterparties meeting the published minimum regulatory requirements (excluding those for liquidity) and buffers including institution-specific minimum regulatory requirements or buffers that may be imposed through supervisory actions (e.g. via "Pillar 2") unless they are not made public. "*If such minimum regulatory requirements and buffers (other than bank-specific minimum requirements or buffers) are not publicly disclosed or otherwise made available by the counterparty institution, then the counterparty institution must be assessed as Grade B or lower [i.e. Grade C].*"
- A classification in *Grade B* requires the counterparty institution to meet the same requirements as for the classification into Grade A, with the exception of capital buffers.
- *Grade C* contains all counterparty institutions which do not fall under Grade A or B.

Qualitative criteria:

- *Grade A* requires the counterparty institutions to have "*adequate capacity to meet their financial commitments (including repayments of principal and interest) in a timely manner,*

for the projected life of the assets or exposures and irrespective of the economic cycles and business conditions".

- *Grade B* refers to exposures to institutions, where the counterparty is subject to substantial credit risk, such as repayment capacities that are dependent on stable or favourable economic or business conditions.
- *Grade C* refers to higher credit risk exposures to institutions, where the counterparty has material default risks and limited margins of safety. For these counterparties, adverse business, financial, or economic conditions are very likely to lead, or have led, to an inability to meet their financial commitments. In addition, an adverse audit opinion by an external auditor in relation to the financial statements of the institution triggers a classification in Grade C.

The assessment of the qualitative criteria may result in the classification of an exposure into a riskier grade, even if the counterparty institution meets the quantitative minimum criteria set out for a less risky grade or has not breached the triggers of the riskier grade, respectively.

In the EU, institutions will be required to publicly disclose in a uniform way to which extent they meet their (minimum) own funds requirements under Pillar 1 and 2 as well as their combined buffer requirement (Article 447 CRR). Even where no such disclosure is required on an individual basis,[15] counterparty institutions may make the information necessary for the classification into the three grades available, not least to benefit from a relatively better credit risk assessment. Similar considerations would appear to apply to non-disclosed requirements of unrated third country institutions.

Questions:

6) Views are sought on the costs and benefits of implementing the definition of grades under the SCRA provided by the Basel III standards (paragraphs 22-29). Please provide relevant evidence to substantiate your views.
7) In your view, are the quantitative and qualitative criteria for the classification of counterparties into grades sufficiently clear or do you consider more specifications necessary to ensure a harmonised application of these criteria throughout the Union? Please elaborate and provide relevant evidence.
8) What are your views in relation to a potential clarification that also minimum capital and buffer requirements beyond the Basel minima (e.g. higher Pillar 1 requirements pursuant to Article 458 CRR or systemic buffers pursuant to Article 133) should be taken into account for the classification into grades, where applicable in the jurisdiction of the counterparty institution?
9) Would you deem any other or further clarifications necessary to perform the classification into the three grades? Please elaborate and provide relevant evidence.

1.1.2.2. Identification of short-term exposures to institutions

[15] Parent and subsidiary institutions as well as institutions (otherwise) included in the prudential consolidation are exempted from the disclosure requirements on an individual basis (Article 6(3) CRR), unless they qualify as large subsidiaries (Article 13 CRR).

Issue: The Basel III standards provide a preferential treatment for short-term exposures to institutions, which was already available under Basel II with the intention not to inhibit the exchange of short-term liquidity between institutions by imposing restrictive RWs to such interbank exposures. For the identification of "interbank" exposures that are eligible for the preferential treatment, their original maturity is relevant, which must not be longer than three months or – newly introduced with Basel III – six months for exposures to institutions that arise from the movement of goods across national borders.
The CRR currently provides for a preferential treatment of short-term (up to three months) interbank exposures, but bases this treatment on the residual maturity of the exposures (Articles 119 and 120), thereby allowing for a wider range of exposures to benefit from this treatment.

Questions:

10) In your view, what are the relative costs and benefits of using the original maturity as opposed to the residual maturity for identifying short-term interbank exposures? Please provide relevant arguments and evidence to substantiate your views.
11) What are your views on the extension of the scope of the preferential treatment for short-term interbank exposures under Basel III from three to six months for exposures to institutions that arise from the movement of goods across national borders? To what extent would the change in definition change the amount of exposures benefitting from the preferential treatment? Please provide relevant evidence to substantiate your views.

1.1.3. Exposures to corporates

1.1.3.1. Treatment of unrated corporates

Issue: The Basel III standards put forward ECRA and SCRA as two mutually exclusive approaches for determining the applicable RWs. Under the ECRA exposures to rated corporates are assigned a RW between 20% and 150% depending on the credit quality, while exposures to unrated corporates are to be risk-weighted at 100%, unless they qualify as small and medium-sized enterprises (SMEs), which are subject to a 85% RW. Under SCRA, a flat RW of 100% applies to all corporate exposures, except for exposures to corporate SMEs (RW of 85%) and to 'investment grade' corporates (RW of 65%). In order to qualify as 'investment grade', amongst others, corporate counterparties or their parent companies must have securities listed on a recognised exchange. This requirement was introduced into the Basel III standards to align the scope of investment grade corporates under SCRA to the extent possible with the scope of externally rated corporates under ECRA; the rationale being that corporates with listed securities typically need an external rating.
According to the current CRR, exposures to unrated corporates shall be assigned a 100% RW or the RW for exposures to the central government of the jurisdiction in which the corporate is incorporated, whichever is the higher (Article 120). However, for exposures up to EUR 1.5 million to unrated corporate SMEs, the CRR currently applies a discount factor of 23.81% of the associated own funds requirements, subject to conditions. In the context of the recent review of the CRR, the threshold for exposures benefitting from this discount factor has been increased to EUR 2.5 million, while for the remaining part of exposures exceeding the threshold of EUR 2.5 million the preferential RW of 85% will apply. The SME-specific treatments apply and will apply, respectively, to both SA and IRB institutions.

Questions:

12) What is the share of your institution's/(member) institutions' exposures to rated and unrated corporate SMEs and to non-SMEs? What is the share of exposures to unrated corporates whose parent companies are externally rated? Please provide relevant evidence (e.g. underlying calculations, studies etc.).
13) Views are sought on the definition of 'investment grade' provided by the Basel III standards (paragraph 42). In particular, would you deem further refinements or clarifications necessary in order to ensure a consistent application across the Union? Please elaborate.
14) What other measures, if any, could be taken to increase the risk-sensitivity of the standardised RW treatment of corporate exposures which currently have no external rating? Please elaborate and provide relevant evidence.
15) In your view, which other aspects, if any, should be considered in the context of revising the standardised treatment of corporate exposures? Please elaborate.

1.1.3.2. Treatment of specialised lending (SL)

Issue: The Basel III standards introduce SL as a sub-set of the corporate exposure class under the SA-CR in order to reflect the associated risk more accurately and improve consistency with the treatment of SL under the internal ratings-based approach (IRBA). The definition of SL under the SA-CR therefore closely follows the definition used under the IRBA, where SL had existed as a separate sub-exposure class already under the Basel II standards and where the treatment remains largely unchanged under the Basel III standards. However, while SL consists of four subcategories under the IRBA, only three of them – project finance, object finance, and commodities finance – are considered specialised lending under the SA-CR. The fourth subcategory of SL under the IRBA – income producing real estate – receives a separate treatment under the SA-CR. In jurisdictions that allow the use of external ratings for regulatory purposes, the applicable RWs for SL exposures with issue-specific ratings range from 20% to 150%, depending on the rating. For SL exposures for which an issue-specific external rating is not available, and for all SL exposures of institutions incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes, RWs ranging from 80% to 130% apply, depending on the relevant subcategory and, in the case of project finance, certain exposure characteristics.

Taking into account the characteristics of exposures to infrastructure projects, a discount factor of 25% of the associated own funds requirements has been introduced in the context of the recent review of the CRR for exposures to infrastructure projects that comply with a set of eligibility criteria capable to lower their risk profile and enhance the predictability of their cash flows. This treatment will apply to both SA and IRB institutions.

Questions:
16) Views are sought on the costs and benefits of implementing the specific treatment of SL exposures provided by the Basel III standards (paragraphs 44-48). In particular, how does this treatment compare with the current treatment in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

17) Would you deem further refinements or clarifications concerning the structure or calibration of the treatment for SL necessary, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.
18) In your view, what other measures should be taken to better reflect the particular characteristics of SL exposures (as compared to general corporate exposures) thereby increasing the risk-sensitivity of the SA-CR and improving consistency with the IRBA? Please elaborate and provide relevant evidence.
19) In your view, which other aspects, if any, should be considered in the context of revising the treatment of SL exposures?

1.1.4. Equity and other capital instruments

1.1.4.1. Standard treatment of equity exposures

Issue: Under the Basel III standards, the RW for equity exposures increases over a 5-years transition period from 100% to 250% to reflect better the higher loss risk of equity compared to senior exposures, to align with the RWs that have previously been applicable under the internal ratings-based approaches (IRBA) according to the Basel II standards, and to prevent regulatory arbitrage between the banking book and the trading book. The Basel III standards furthermore clarify the scope of the equity exposure class by providing a definition of equity exposures and specifying which other instruments are to be categorised as equity exposures when calculating the RWA for credit risk (see paragraph 49).

Questions:

20) In your view, are there any issues with the definition of equity exposures provided by the Basel III standards (paragraph 49) and the list of other instruments to be treated alike? In particular, would you deem further refinements or clarifications necessary regarding the scope of the equity exposure class in order to ensure a consistent application across the Union? Please elaborate.
21) Views are sought on the costs and benefits of the revised standard treatment for equity exposures under Basel III (paragraph 49-50). In particular, would you consider any further differentiation among equity exposures (apart from "speculative unlisted equity exposures" and "national legislated programmes" – see 1.1.4.2. and 1.1.4.3.) warranted, and if so, how should this differentiation be made and what would be its prudential rationale? Please elaborate and provide relevant evidence.
22) What other measures or safeguards could be put in place with regards to equity exposures to increase the risk-sensitivity and robustness of the credit risk framework and prevent regulatory arbitrage between the banking book and the trading book? Please elaborate and provide relevant evidence.

1.1.4.2. Treatment of 'speculative unlisted equity exposures'

Issue: According to the Basel III standards, an elevated risk weight of 400% should be applied to 'speculative unlisted equity exposures'. These exposures are defined as "*equity investments in unlisted companies that are invested for short-term resale purposes or are considered venture*

capital or similar investments, which are subject to price volatility and are acquired in anticipation of significant future capital gains" (paragraph 51).

The CRR currently subsumes "investment in venture capital firms" and "investments in private equity" under high risk exposures which are subject to a 150% RW (Article 128), but without providing any further definition of these investments. Additional guidance with regard to the identification of investments in private equity and venture capital firms has been provided by the EBA through its Guidelines on specification of types of exposures to be associated with high risk[16].

Questions:

23) Do you agree that speculative unlisted equity exposures such as investments in private equity or venture capital firms should be subject to a relatively higher RW than other equity exposures? If you disagree, please explain and provide relevant evidence to substantiate your view.

24) Views are sought on the definition of 'speculative unlisted equity exposures' provided by the Basel III standards (paragraph 51 and footnote 31). In particular, would you deem further refinements or clarifications necessary and if yes, what should those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

25) What other measures could be put in place to address the elevated risk from unlisted equity exposures? Please elaborate and provide relevant evidence.

1.1.4.3. Treatment of equity holdings made pursuant to national legislated programmes

Issue: To promote certain specified sectors of the economy,[17] the Basel III standards provide for a discretion to allow institutions to assign a RW of 100% to equity holdings made pursuant to national legislated programmes that provide significant subsidies for the investment to the institution and involve government oversight and restrictions on the equity investments. Such treatment can only be accorded to equity holdings up to an aggregate of 10% of the institution's combined Tier 1 and Tier 2 capital. Examples of restrictions are limitations on the size and types of businesses in which the institution is investing, allowable amounts of ownership interests, geographical location and other pertinent factors that limit the potential risk of the investment to the institution (see paragraph 52).

Already the Basel II standards provided a discretion on equity holdings in national legislated programmes, allowing institutions that otherwise use the IRBA for calculating their own funds requirements to apply to the respective exposures the 100% RW under the SA (instead of potentially higher RWs under the IRBA). The current CRR implements this discretion in Article 150.

Questions:

26) In your view, should the discretion for "national legislated programmes" provided by the Basel III standards should be implemented in the Union? If you disagree, please explain and provide relevant evidence to substantiate your view.

[16] See https://eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-specification-of-types-of-exposures-to-be-associated-with-high-risk

[17] In certain jurisdictions, "national legislated programs" are used to promote equity investments of institutions in corporations or projects that are primarily designed to promote community welfare (e.g. the redevelopment of lower-income areas and services to support lower-income populations.

27) Would you deem additional safeguards necessary to ensure that only exposures under legislative programmes that effectively reduce the risk can benefit from the preferential RW? For instance, should the preferential RW for exposures subject to national legislated programmes be made dependent on evidence of lower riskiness of respective exposures, and if yes, what kind of evidence would be adequate?
28) In your view, how should "national legislated programmes" be defined within the context of the Union? In particular, would you deem further refinements or clarifications necessary concerning the existing definition, and if yes, what would those be and what would be their prudential rationale? Please elaborate.

1.1.5. Retail exposures

1.1.5.1. Notion of 'transactors' and 'other retail'

Issue: With the intention to increase granularity in the standardised RWs, the Basel III standards introduce transactors as new sub-exposure class for regulatory retail exposures and specify the treatment for other retail exposures. As a result retail exposures are now split into three (sub-) categories: regulatory retail exposures that qualify as exposures to transactors, regulatory retail exposures that do not qualify as exposures to transactors, and other retail exposures. An exposure qualifies as an exposure to a transactor if it fulfils the conditions for regulatory retail exposures and in addition is an exposure to facilities such as credit cards and charge cards where the balance has been repaid in full at each scheduled repayment date for the previous 12 months or to overdraft facilities if there have been no drawdowns over the previous 12 months. Exposures to transactors benefit from a reduced RW of 45%, while under the current CRR in line with the Basel II standards, all regulatory retail exposures are assigned a RW of 75%.
Other retail exposures will be risk-weighted at 100% under Basel III, whereas the CRR currently does not provide a specific treatment but just excludes such exposures from the preferential RW for retail.

Questions:
29) Views are sought on the costs and benefits of introducing the sub-asset class of transactors for regulatory retail exposures and specifying the treatment for other retail exposures. In particular, how does the approach provided by the Basel III standards compare with the current approach in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.
30) In your view, does the reduction in RWs for exposures to transactors under Basel III prudently reflect the risks associated with such exposures? Please elaborate and provide relevant evidence.
31) Would you deem further clarifications necessary concerning the notion of transactors and other retail, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.
32) In your view, which other aspects, if any, should be considered in the context of revising the treatment of retail exposures? Please elaborate and provide relevant evidence.

1.1.5.2. 'Granularity criterion' and additional measures to ensure diversification

Issue: To ensure sufficient diversification of the regulatory retail portfolio the Basel II standards already contained a 'granularity criterion' for classifying exposures as 'regulatory retail'. The Basel II standards state that "*one way of achieving this [sufficient diversification] may be to set a numerical limit that no aggregate exposure to one counterpart can exceed 0.2% of the overall regulatory retail portfolio*" (paragraph 70). The Basel III standards elevate the 0.2% threshold from an example to the default option, without changing the substance of the granularity criterion, stating that "*no aggregated exposure to one counterparty can exceed 0.2% of the overall regulatory retail portfolio, unless national supervisors have determined another method to ensure satisfactory diversification of the regulatory retail portfolio*" (paragraph 55).
In the EU, the CRR lays down the granularity criterion for retail exposures, requiring that the "*exposure shall be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced*" (Article 123). This CRR requirement, in conjunction with the supervisory scrutiny applied by competent authorities, intends to ensure sufficient diversification of retail portfolios.

Questions:

33) In your view, is the current CRR sufficiently clear to ensure a harmonised application of the "granularity criterion" or do you consider further guidance necessary? If yes, what are your views as to what this further guidance should entail?

1.1.6. Real estate (RE) exposures

1.1.6.1. Implementation of loan splitting (LS) approach vs whole loan (WL) approach

Issue: The Basel III standards provide two alternative approaches for assigning RWs to real estate (RE) exposures: The LS approach splits mortgage loans into a secured and an unsecured part (implicitly using the loan-to-value (LTV) ratio) and assigns a different RW to each of these two parts, thereby conceptually following the current approach of the CRR (Articles 124 to 126). The WL approach considers mortgage loans as specific products and assigns a RW to the entire exposure based on its LTV ratio using different LTV buckets. The rationale for using the LTV ratio as risk driver for determining the applicable RWs is that the losses incurred in the event of a default and the likelihood of a borrower's default are lower when the outstanding loan amount relative to the value of the RE collateral (i.e. the LTV ratio) is lower. However, only the LS approach is also sensitive to the type of borrower (as it applies the RW of the counterparty to the unsecured part) and reflects the risk mitigating effects of RE collateral in the applicable RWs even in case of high LTV ratios.

Questions:

34) Views are sought on the relative costs and benefits of the LS approach and the WL approach provided by the final Basel III standard. In particular, how do the two approaches compare in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.
35) Would you deem further refinements or clarifications necessary concerning the approach that you generally prefer, and if yes, what would those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.
36) What would justify implementing both approaches in parallel from a risk perspective? If both approaches were to be implemented and made available on discretionary basis, how

would comparability across institutions be ensured and how would regulatory arbitrage as well as undue complexity be prevented in this case?

1.1.6.2. Treatment of exposures where the servicing of the loan materially depends on the cash flows generated by a portfolio of properties owned by the borrower

Issue: The Basel III standards introduce a specific RW-treatment for RE exposures where the prospects for servicing the loan materially depend on the cash flows generated by the property securing the loan rather than on the underlying capacity of the borrower to service the debt from other sources (so-called "income producing real estate (IPRE)). This modification is intended to reflect the associated risk more accurately and improve consistency with the treatment of IPRE under the IRBA. According to the SA-CR standards "*[t]he distinguishing characteristic of IPRE versus other corporate exposures that are collateralised by real estate is the strong positive correlation between the prospects for repayment of the exposure and the prospects for recovery in the event of default, with both depending primarily on the cash flows generated by a property securing the exposure*" (see paragraphs 67 and 73). The default approach laid down in the Basel III standards for assessing whether such a strong positive correlation exists is to look at the cash flows generated by the respective individual property in relation to all other cash flows of the borrower. However, the Basel III standards also contain a discretion to conduct this assessment by checking whether the servicing of the loan materially depends on the cash flows generated by a portfolio of properties owned by the borrower.

Questions:

37) Do you consider the assessment of the condition of "strong positive correlation" on a portfolio basis more appropriate than the assessment based on the individual RE exposure, and if yes, why? Please explain.
38) If the assessment based on a portfolio basis were introduced, what are your views on whether it should be the only approach available in the Union or it should be an alternative approach to be applied at supervisory discretion on a case-by-case basis? Please explain.

1.1.6.3. Eligibility of property under construction

Issue: According to the Basel III standards, in order for mortgage loans to be eligible for the preferential treatment provided for the RE exposure class, among others, the property securing the exposure must be 'fully completed' (see paragraph 60). At the same time, the Basel III standards provide a discretion to treat loans to individuals that are secured by residential property under construction as RE exposures. However, this preferential treatment is only available provided that the property under construction is a one-to-four family residential housing unit that will be the primary residence of the borrower (this does not include apartments within a larger construction project) or where the sovereign or PSEs have the legal powers and ability to ensure that the property under construction will be finished (see paragraph 60). Owner-occupied RE is supposed to have a lower credit risk, since the owner is expected to be more motivated to repay the loan for his/her own residence compared to other loans. The number of housing units within a property under construction that can be recognised as collateral is set at four, to take account of the situation that own-occupied houses are sometimes built with separate units for more than one family generation.
The current CRR already reflects the lower credit risk of owner-occupied RE, but without setting a clear threshold for the number of property under construction (Article 125).

Questions:

39) What are your views on the costs and benefits of implementing the preferential treatment for certain properties under construction as provided by the Basel III standards? Please provide relevant evidence supporting your view.
40) Do you consider the threshold of one-to-four family residential housing units appropriate, and if not, which other threshold would you consider to be more appropriate? Please provide evidence supporting your view.

1.1.6.4. Prudently conservative valuation criteria

Issue:The Basel III standards no longer distinguish between the market value (MV) concept and the mortgage lending value (MLV) concept for determining the value of RE collateral, but set out some general valuation criteria in paragraph 62 in order to simplify the treatment of RE exposures and make it more robust: "*[T]he valuation must be appraised independently using prudently conservative valuation criteria. To ensure that the value of the property is appraised in a prudently conservative manner, the valuation must exclude expectations on price increases and must be adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan. National supervisors should provide guidance setting out prudent valuation criteria where such guidance does not already exist under national law. If a market value can be determined, the valuation should not be higher than the market value.*"

Questions:

41) Views are sought on the costs and benefits of the valuation criteria provided by the Basel III standards. In particular, how does this approach compare with the current approaches available under the CRR (MV and MLV) in terms of simplicity, comparability, risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.
42) Would you deem additional specifications necessary to clarify how the MV or the MLV currently used by institutions would need to be adjusted to meet the valuation criteria provided by the Basel III standards? Would you deem further clarifications necessary to ensure a consistent application of the valuation criteria across the Union? Please elaborate.
43) What other measures could be taken to ensure that the value of RE collateral is sustainable over the life of the loan? Please elaborate and provide relevant evidence.
44) In your view, which other aspects, if any, should be considered in the context of revising the valuation criteria for RE property? Please explain.

1.1.6.5. (Re-)valuation: value at origination vs. current value

Issue: The Basel III standards state that the value of the property recognised for prudential purposes has to be capped at the property value measured at loan origination to reduce the possible cyclical effects of the valuation and keep own funds requirements for RE exposures more stable.
However, the current CRR (Article 208) requires the monitoring and, where indicated, the revaluation of RE collateral without preventing possible value adjustments upwards to reflect the increase in market value in particular where mortgage loans have long maturities.

Questions:

45) Views are sought on the costs and benefits of capping the property value at loan origination. In particular, how does the approach provided by the final Basel III standards compare with the current approach of the CRR in terms of possible cyclical effects on RWs, risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.
46) What other measures or safeguards could be provided to address possible cyclical effects of the re-valuation of real estate property? Please elaborate and provide relevant evidence.
47) In your view, which other aspects, if any, should be considered in the context of revising the requirement for re-valuation of RE collateral? Please elaborate and provide relevant evidence to substantiate your views.

1.1.6.6. Land acquisition, development and construction (ADC) exposures – general treatment

Issue: With a view to increasing the risk sensitivity and robustness of the SA-CR, the Basel III standards introduce ADC as a new subset of RE exposures, which includes loans financing any of the land acquisition, development or construction of any properties where the source of repayment at origination of the exposure is either the future uncertain sale of the property or cash flows whose source is substantially uncertain (e.g. the property has not yet been leased to the occupancy rate prevailing in that geographic market for that type of real estate). ADC exposures are to be risk-weighted at 150% unless they meet certain criteria (see below 1.1.6.7.).

Similarly, the CRR currently requires the application of a 150% RW to 'speculative immovable property financing' (Article 128) which includes "*loans for the purposes of the acquisition of or development or construction on land in relation to immovable property, or of and in relation to such property, with the intention of reselling for profit*" (Article 4(1)(79)). Financing solely the acquisition of finished immovable property where the properties are acquired for resale purposes is hence to be treated as speculative immovable property financing under the CRR, but would not be included in the scope of ADC under Basel III, as the latter only refers to the acquisition of land for development and construction purposes but not to the acquisition of immovable properties.

Questions:

48) What are your views on the costs and benefits of replacing the existing treatment of 'speculative immovable property financing' with the treatment of ADC exposures as provided by the Basel III standards?
49) Would you deem further refinements or clarifications necessary concerning the scope or definition of ADC exposures, and if yes, what would those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

1.1.6.7. ADC exposures – conditions for the application of 100% RW

Issue: The Basel III standards allow for the application of a preferential RW of 100% to ADC exposures where the general underwriting requirements applicable to RE exposures are met and the following condition is fulfilled: "*Pre-sale or pre-lease contracts amount to a significant portion of total contracts or substantial equity at risk. Pre-sale or pre-lease contracts must be legally binding written contracts and the purchaser/renter must have made a substantial cash*

deposit, which is subject to forfeiture if the contract is terminated. Equity at risk should be determined as an appropriate amount of borrower-contributed equity to the real estate's appraised as-completed value" (paragraph 75). The meaning of the terms 'significant portion of total contracts', 'substantial equity at risk' and 'substantial cash deposits' is not further specified.

Questions:

50) In relation to the condition for applying the preferential risk weight of 100% to certain ADC exposures, do you consider further specification necessary to ensure a harmonised application of this condition across the Union, for example by defining or quantifying any of the terms mentioned above? Please elaborate and provide relevant evidence to substantiate your views.

1.1.7. RW multiplier to certain exposures with currency mismatch

Issue: The Basel III standards introduce a 1.5 multiplier for the RW applicable to "retail and residential RE exposures to individuals where the lending currency differs from the currency of the borrower's source of income" and where the borrowers have no natural or financial hedge against the foreign exchange risk resulting from the aforementioned currency mismatch. The resulting maximum RW to be applied is capped at 150%. Neither the Basel II standards nor the CRR contain a comparable provision. This provision is meant to address the higher credit risk that is deemed to be associated with exposures with a currency mismatch compared to those without currency mismatch.

Questions:

51) What are your views on the costs and benefits of introducing the RW multiplier described above? Please provide relevant evidence to substantiate your views.

52) In your view, what other measures could be taken to address the risks associated with currency mismatches? Would the restriction of this measure to retail and residential RE exposures to individuals be appropriate to tackle such risks in the EU? Please elaborate and provide relevant evidence.

53) In your view, which other aspects, if any, should be considered in the context of revising the treatment of exposures with currency mismatch under the SA-CR? Please provide relevant evidence to substantiate your views.

1.1.8. Off-balance sheet (OBS) items

1.1.8.1. Definition of commitment

Issue: The Basel III standards introduce a definition of commitment with the aim to clarify one of the main concepts for the application of the credit risk framework to OBS items and to ensure consistency between the SA-CR and the IRBA (see 1.2.7.). In particular, 'commitment' means "*any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes. It includes any such arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor. It also includes any such arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility documentation, including conditions that must be met by the*

obligor prior to any initial or subsequent drawdown under the arrangement" (paragraph 78). This definition explicitly includes unconditionally cancellable commitments (UCC). However, the Basel III standards provide a national discretion in footnote 53 whereby certain arrangements for corporates and SMEs can be exempted from the definition of commitments if a number of conditions are met.

Questions:

54) What is your view on the Basel III definition of commitments? Please provide relevant evidence to substantiate your views.
55) What is your view on the national discretion to exempt certain arrangements for corporates and SMEs from the definition of commitments? In your view, which arrangements should be exempted from the definition of commitment, if any? Please provide relevant evidence to substantiate your views.
56) In your view, which other aspects, if any, should be considered in the context of the treatment of off-balance sheet exposures? Please provide relevant evidence to substantiate your views.

1.1.8.2. New credit conversion factors (CCF)

Issue: The Basel III standards modify the treatment of OBS items by introducing additional buckets of CCF. While the Basel II standards offered four different buckets (0%, 20%, 50% and 100%), the Basel III standards add two further buckets (10% and 40%), with the intention to make the treatment of OBS items more risk sensitive.
The CRR has implemented the Basel II standards, which are of a principle-based nature (i.e. they provide the main features that should be associated with each level of CCF), by providing a more detailed (although non exhaustive) list of the exposures assigned to each of the four buckets.
The reformed buckets result in the following main changes: a 10% CCF applies to UCCs instead of 0%; a 40% CCF applies to all other commitments, regardless of the maturity of the underlying facility while according to the current rules the corresponding CCFs are 20% for commitments with a maturity up to one year and 50% for all other commitments.

Questions:

57) What are the costs and benefits of the new CCF introduced by the Basel III standards? In particular, how does the Basel III treatment of OBS items compare to the current treatment in terms of risk-sensitivity and impact on RWAs. Please provide relevant evidence to substantiate your views.
58) In your view, which other aspects, if any, should be considered in the context of revising the treatment of OBS exposures? Please provide relevant evidence to substantiate your views.

1.1.9. Other provisions

Questions:

59) In your view, which other aspects, if any, should be considered in the context of revising the SA-CR? Please elaborate and rank your answers from the most important to the least important aspect.

1.1.10. Implementation challenges and administrative burden

Questions:

60) Which elements of the revised SA-CR, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

61) Which elements of the revised SA-CR, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

1.2. INTERNAL RATINGS BASED APPROACHES (IRBA)

1.2.1. Reduction of the scope of internal modelling

Issue: The Basel III standards disallows the use of the Advanced IRBA (AIRBA) – under which institutions estimate probability of default (PD), loss given default (LGD), exposure at default (EAD) and maturity of an exposure – for exposures to corporates with consolidated annual revenues above €500 million and for exposures to institutions and other financial institutions. By contrast, the Basel II standards and the CRR do allow the use of the AIRBA in these cases. The Basel Committee considers that the low number of defaults observed in these asset classes makes it impossible for institutions to model all of the required risk parameters in a robust manner, and that disallowing the use of the AIRBA therefore removes an important source of RWA variability. The Foundation IRBA (FIRBA) remains available. In addition, and for similar reasons, the Basel III standards disallow the use the IRBA for equity exposures and instead require institutions to use the SA-CR (see 1.1.4.).

Questions:

62) What are your views on the costs and benefits of reducing the scope of internal modelling as described above? In particular, how would this reform impact the robustness and levels of RWAs for the affected portfolios? Please provide relevant evidence to substantiate your views.

63) What other measures could be put in place to improve the robustness of internal estimates for the relevant asset classes? Please elaborate and provide relevant evidence.

64) In your view, which other aspects, if any, might be considered in the context of the revision of the scope of internal modelling to address RWA variability? Please provide relevant evidence to substantiate your views.

1.2.2. PD – increase of the input floor

Issue: The Basel III standards require for each exposure with the exception of exposures in the sovereign asset class that the PD that is used as input into the IRBA RW formula and the calculation of expected loss must not be less than 0.05%. This percentage – a so-called input floor – constitutes an increase compared to the previous floor of 0.03% (which is implemented in the EU in Article 160 CRR) and is meant to ensure a minimum level of conservatism in model parameters while reducing undue RWA variability.

Questions:

65) Views are sought on the costs and benefits of increasing the PD input floor to 0.05%. In particular, how does the increased floor compare with the current floor in terms of achieving the aim of decreased RWA variability? What is the impact of this change on RWA levels? Please provide relevant evidence to substantiate your views.

66) In your view, how does the increased floor compare with the current floor in terms of achieving the aim of increased conservatism? Would you consider a floor that implicitly assumes that a default occurs once every 2000 years to be sufficiently prudent? Please explain.

67) What other requirements or safeguards could be implemented in the area of PD estimation to achieve a minimum level of conservatism and/or reduce RWA variability? Please provide relevant evidence to substantiate your views.
68) In your view, which other aspects, if any, should be considered in the context of revising the PD input floor? Please provide relevant evidence to substantiate your views.

1.2.3. LGD – input floors under AIRBA

Issue: The Basel III standards require for each exposure treated under the AIRBA (with the exception of exposures in the sovereign asset class) that the LGD that is used as input into the IRB RW formula and the calculation of expected loss must not be less than certain percentages. These percentages – so-called input floors – apply to secured and unsecured exposures and range from 0% to 50%, depending on the type of the exposure and on the type of any applicable collateral (see paragraphs 85 and 121). The Basel III standards furthermore introduce a formula for the calculation of the input floor for partially secured exposures (see paragraph 86). The LGD input floors constitute a significant change from the LGD floors of the Basel II framework (which apply at portfolio level to exposures secured by immovable property and are implemented in Article 164 CRR) and are intended to ensure a minimum level of conservatism in model parameters while reducing undue RWA variability.

Questions:
69) Views are sought on the costs and benefits of exposure-level LGD input floors. In particular, how do the floors compare with the current treatment in terms of achieving the aims of conservatism and RWA variability? What is the impact of this change on RWAs? Please provide relevant evidence to substantiate your views.
70) As regards the different types of exposures and collateral, to what extent do you consider that the LGD input floors maintain an adequate level of risk sensitivity with respect to the wide range of practices of EU institutions?
71) What other requirements or safeguards could be implemented in the area of LGD estimation to achieve a minimum level of conservatism and/or reduce RWA variability?
72) In your view, which other aspects, if any, should be considered in the context of revising the LGD input floor? Please provide relevant evidence to substantiate your views.

1.2.4. LGD – regulatory values under FIRBA

Issue: The Basel III standards modify the regulatory LGD values to be used under the FIRBA for both unsecured and secured exposures. For unsecured exposures, the regulatory LGD value for corporate exposures decreases from 45% to 40%. For secured exposures, the framework is adapted in a number of ways. A new formula is introduced to compute the regulatory LGD value for secured exposures (paragraph 74), which gives a uniform presentation of the two existing approaches to the recognition of collateral within the FIRBA and is meant to simplify the framework and to lead to more consistent interpretation and implementation. The minimum collateralisation requirement (paragraph 295 of Basel II, implemented in Article 230 CRR) is removed, the regulatory LGD values for secured exposures are reduced and the collateral haircuts are recalibrated. The overall effect of the changes relating to secured exposures is a greater sensitivity of regulatory LGDs to collateral values, leading to progressively lower risk weights compared to the current framework.

Questions:

73) Views are sought on the costs and benefits of the revised regulatory LGD values to be used under the FIRB Approach. In particular, how does the approach provided by the Basel III standards compare with the Basel II standards in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

74) In your view, are the regulatory LGD values sufficiently prudent in light of the decrease of the regulatory LGD value for unsecured corporate exposures and the changes affecting secured exposures? Please explain and provide relevant evidence to substantiate your views.

75) In your view, which other aspects, if any, should be considered in the context of revising the regulatory LGD values to be used under the FIRB Approach? Please provide relevant evidence to substantiate your views.

1.2.5. EAD – introduction of an input floor

Issue: The Basel III standards require for each exposure treated under the AIRBA (with the exception of exposures in the sovereign asset class) that own estimates of EAD that are used as input into the RW formula and the calculation of expected loss are not lower than the sum of: (i) the on balance sheet amount; and (ii) 50% of the OBS exposure using the applicable CCF in the SA (see paragraph 105). This so-called “input floor”, for which there is no precedent in the current framework, is intended to ensure a minimum level of conservatism in model parameters while reducing undue RWA variability.

Questions:

76) Views are sought on the costs and benefits of exposure-level EAD input floors. In particular, how do the floors compare with the current treatment in terms of achieving the aims of conservatism and RWA variability? What is the impact of this change on RWAs? Please provide relevant evidence to substantiate your views.

77) What other requirements or safeguards could be implemented in the area of EAD estimation to achieve a minimum level of conservatism and/or reduce RWA variability?

78) In your view, which other aspects, if any, might be considered in the context of revising the EAD input floor? Please provide relevant evidence to substantiate your views.

1.2.6. EAD – Scope of modelling

Issue: The Basel III standards restrict the use of own internal estimates of EAD to undrawn revolving commitments to extend credit, purchase assets or issue credit substitutes provided the exposure is not subject to a CCF of 100% in the FIRBA (see paragraph 105 for non-retail exposures and paragraph 125 for retail exposures).
By contrast, no comparable product-based restriction to EAD modelling exists in the current framework (as implemented in Article 166 CRR). The intention of the modification is to address unwarranted RWA variability. In light of this restriction of EAD modelling, the definition of undrawn revolving commitment (see 1.1.8.1 – in the SA-CR section) has particular importance.

Questions:

79) Views are sought on the costs and benefits of restricting the use of EAD modelling to undrawn revolving commitments. In particular, how would the removal of EAD modelling for other product types impact the robustness and level of RWAs for those portfolios?

80) What other measures could be put in place to improve the robustness of internal estimates of EAD? Please specify and provide relevant evidence.

81) In your view, which other aspects, if any, should be considered in the context of the revision of the scope of internal modelling of EAD? Please provide relevant evidence to substantiate your views.

1.2.7. EAD – regulatory CCF values

Issue: Under the FIRBA, the Basel III standards require the use of the same regulatory CCFs as those used under the SA (see paragraph 102). The Basel II standards contained the same rule in principle, but deviated from this principle for a number of product types (implemented in Article 166 CRR). For institutions applying these regulatory CCFs, the regulatory CCFs may thus change either because of the new direct reference to the SA CCFs or because of the modifications of the SA CCFs (as discussed in 1.1.8.2.). The intention of the modification is to address unwarranted RWA variability.

82) What are your views on the costs and benefits of using SA CCFs for the FIRB Approach? How would this change impact the robustness and level of RWAs for the affected portfolios?

83) What other measures could be put in place to improve the adequacy of the regulatory CCFs under the FIRB Approach? Please elaborate and provide relevant evidence.

84) In your view, which other aspects, if any, should be considered in the context of the revision of the regulatory CCFs under the FIRB Approach? Please provide relevant evidence to substantiate your views.

1.2.8. Maturity factor – clarifications on the calculation of effective maturity

Issue: For institutions using the AIRBA, the Basel III standards require that, for revolving exposures, effective maturity must be determined using the maximum contractual termination date of the facility, and that institutions must not use the repayment date of the current drawing. This requirement is intended to be a clarification of paragraph 320 of the Basel II agreement (as implemented in Article 162 CRR) that already provides that effective maturity M should be set to the maximum remaining time that a borrower is permitted to take to fully discharge its contractual obligations under the terms of the loan agreement. This clarification is part of the Basel Committee's general attempt to limit the range of practices regarding the estimation of model parameters under the IRB approaches to reduce unwarranted variability in RWA and to simplify the credit risk framework.

Questions:

85) What are your views on the costs and benefits of the proposed clarification regarding the determination of effective maturity? In particular, how would the proposed change impact the robustness and level of RWAs under the AIRB Approach?

86) In your view, which other aspects, if any, should be considered in the context of the treatment of the maturity parameter? Please provide relevant evidence to substantiate your views.

1.2.9. Sovereign exposures – no substantive change

Issue: In parallel to the discussions on the finalisation of Basel III, the BCBS also conducted a separate review of the regulatory treatment of sovereign exposures. The result of this review was published in a discussion paper alongside the Basel III standards, the main conclusion being that "*the Committee has not reached a consensus to make any changes to the treatment of sovereign exposures*". As regards sovereign exposures under the IRBA, this has resulted in the Basel standards stating that "*the treatment of sovereign exposures is unchanged from the Basel II framework (June 2006)*". However, the BCBS recognised that a strict interpretation of this "no change" principle as regards the IRBA would have undesirable consequences, as it would create significant complexity that would neither be necessary to achieve the desired policy outcome nor prudentially justified. As a result, when the BCBS published a draft consolidated framework[18] in April 2019, it clarified in this framework that the December 2017 agreement is to be understood to mean that sovereign exposures are "exempted" merely from the arguably most restrictive modifications of the IRBA. Specifically, both the AIRBA and the FIRBA remain available for sovereign exposures, and no input floors apply to them. On the other hand, other (more technical) changes, such as those pertaining to data requirements for PD estimation, do apply to sovereign exposures in the same way as they do to corporate exposures and exposures to institutions. Also, it should be noted that the removal of the 1.06 scaling factor also applies to sovereign exposures, and that sovereign exposures are included in the calculations of the output floor.

Questions:

87) Views are sought on the treatment of sovereign exposures proposed in the BCBS consolidated framework referred to above. In your view, how would the exemption from the removal of the IRBA and from the input floors, on the one hand, and the implementation of the remaining reforms of the IRBA, on the other hand, impact the robustness and levels of RWAs for sovereign exposures treated under the IRBA?

1.2.10. Sovereign exposures – public sector entities (PSEs) and regional governments and local authorities (RGLAs)

Issue: The Basel III standards do not specifically address the treatment of exposures to PSEs and RGLAs. However, as these exposures continue to be treated in the IRBA either like exposures to central governments or as exposures to institutions, they are affected by the changes to the treatment of these asset classes. Specifically, the revised Basel framework leaves the rules applicable to exposures to central governments largely unchanged (see 1.2.9.), while the rules applicable to exposures to institutions are subject to significant modifications intended to increase the robustness of internal modelling (see 1.2.1.). Most importantly, for exposures to institutions, the AIRBA would no longer be available, and a fixed LGD parameter and an increased PD input floor would apply under the FIRBA. By contrast, for exposures to central governments the AIRBA would continue to be available, and no input floors would apply.

[18] See https://www.bis.org/press/p190409.htm

Under the current framework, whether a PSE or RGLA is treated as central government or as institution under the IRBA is of relatively limited significance for the purpose of RWA calculations, as the rules applicable to each of these two asset classes are broadly similar. However, as a result of the aforementioned changes to the treatment of exposures to institutions under the revised framework, whether a PSE or RGLA is treated as central government or as institution would have potentially significant implications. For example, it can be expected that exposures to those PSE and RGLAs treated as central governments would see a reduction in RWAs (as a result of the removal of the 1.06 scaling factor), while exposures to those PSE and RGLAs treated as institutions would see an increase in RWAs (as a result of the input floors).

Questions:

88) What are your views on the costs and benefits of the proposed treatment of PSEs and RGLAs resulting from the changes applicable to exposures to central governments and exposures to institutions compared to the current framework? Please elaborate and provide relevant evidence.
89) In your view, are there other ways to achieve more robust RWA estimates for exposures to PSEs and RGLAs that would mitigate the potentially significant differences in treatment described above? Which are they and what would be their costs and benefits and their prudential justification?
90) In your view, which other aspects, if any, should be considered in the context of the revision of the treatment of PSEs and RGLAs? Please provide relevant evidence to substantiate your views.

1.2.11. Additional enhancements of IRB risk parameter estimation practices

Issue: In addition, to the aforementioned reforms, the Basel III standards contain a significant number of modifications that provide greater specification of the practices that institutions may use in the calculation of internal risk parameter estimates. These modifications affect all risk parameters and are intended to reduce unwarranted RWA variability.

Questions:

91) What are your views on the proposed enhancements of IRB risk parameter estimation practices?
92) What other measures could be put in place to improve the robustness of internal estimates? Please elaborate and provide relevant evidence.
93) In your view, which other aspects, if any, should be considered in the context of the revision of estimation practices to address unwarranted RWA variability? Please provide relevant evidence to substantiate your views.

1.2.12. Other provisions

Questions:

94) In your view, which other aspects, if any, should be considered in the context of revising the IRBA? Please elaborate and rank your answers from the most important to the least important aspect.

1.2.13. Implementation challenges and administrative burden

Questions:

95) Which elements of the revised IRBA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

96) Which elements of the revised IRBA, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

1.3. CREDIT RISK MITIGATION – SA-CR

1.3.1. Removal of own estimates of haircuts and use of supervisory haircuts

Issue: In the comprehensive approach under the Basel III standards, institutions must use supervisory haircuts to adjust the exposure amount as well as the value of received collateral. The haircuts must take account of possible future fluctuations in the value of the exposure and the collateral value. Institutions are no longer allowed to use their own haircut estimates to reduce unwarranted RWA variability and increase comparability.

Questions:

97) What are the costs and benefits of replacing own estimates of haircuts with the use of supervisory haircuts? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.
98) Do the revisions affect certain exposure classes more than others? Please elaborate and provide relevant evidence to substantiate your views.

1.3.2. Specific operational requirements for credit derivatives: restructuring as a credit event

Issue: In order to be recognised for credit risk mitigation purposes, a credit derivative must meet several operational requirements under the Basel III standards, including the specification of certain credit events. Credit events generally must include the restructuring of the underlying obligation. This particular event is not required in the case of hedges for corporate exposures under conditions set out in footnote 83 of the Basel III standards.

Questions:

99) What are the costs and benefits of the recognition of credit derivatives in cases where restructuring is not specified as a credit event? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.
100) Do the revisions affect certain exposure classes more than others? Please elaborate and provide relevant evidence.

1.3.3. No recognition of nth-to-default products as eligible CRM technique

Issue: In order to be recognised, purchased credit protection must cover the entire underlying pool according to the Basel III standards. If it covers only a subset of the pool, as in the case of nth-to -default credit derivatives, in general the credit protection cannot be recognised.

Questions:

101) What are the costs and benefits of not recognising nth-to-default credit protection? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on

RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

1.3.4. Other provisions

Questions:
102) In your view, which other aspects, if any, should be considered in the context of revising the CRM framework under the SA-CR? Please specify and rank your answers from the most important to the least important aspect.

1.3.5. Implementation challenges and administrative burden

Questions:
103) Which elements of the revised of the CRM framework under the SA-CR, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.
104) Which elements of the revised CRM framework under the SA-CR, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

1.4. CREDIT RISK MITIGATION – IRBA

1.4.1. Unfunded credit protection (UFCP) – the treatment of AIRB exposures secured by SA-CR or FIRB guarantors

Issue: Under the Basel III standards, where an obligor is treated under the AIRBA and where this exposure is guaranteed by a guarantor treated under the FIRBA or SA-CR, the final RW should be computed according to the approach applied to direct exposures to the guarantor.

Questions:
105) What are the costs and benefits of the revised treatment of AIRB exposures secured by SA-CR or FIRB guarantors? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.
106) Would you deem further refinements or clarifications necessary in this context to ensure consistency across the Union? Please elaborate and provide relevant evidence.

1.4.2. UFCP – relevant risk weight function and input floors to be used under the substitution approach

Issue: For the purpose of recognising the credit risk mitigating effects of UFCP, the risk weight function of the guarantor, including parameter input floors, should be used. This is to ensure that no better treatment under the CRM framework can be achieved than the one applicable to a comparable, direct exposure to the guarantor.

Questions:

107) What are the costs and benefits of the revised treatment of UFC under the substitution approach? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

1.4.3. Eligibility and treatment of conditional guarantees

Issue: The Basel III standards render conditional guarantees ineligible for recognition under the SA-CR as well as under the IRBA. As an exception to this general rule, for the purpose of own EAD estimates institutions can continue to recognise guarantees that only cover losses remaining after the institution has first pursued the original obligor for payment and has completed the workout process.

Questions:

108) What are the costs and benefits of the limited recognition of conditional guarantees? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

1.4.4. Other provisions

Questions:

109) In your view, which other aspects, if any, should be considered in the context of revising the CRM framework under the IRBA? Please specify and rank your answers from the most important to the least important aspect.

1.4.5. Implementation challenges and administrative burden

Questions:

110) Which elements of the revised CRM framework under the IRBA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

111) Which elements of the revised CRM framework under the IRBA, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

2. Securities financing transactions (SFTs)

2.1. Minimum haircut floors for certain SFTs

Issue: The Basel III standards introduce a minimum haircut floors framework for non-centrally cleared SFTs in which institutions provide financing to non-banks against collateral other than government securities ('in-scope SFTs'). Under this framework, institutions that engage in those SFTs are required to receive from non-banks a minimum amount of over-collateralisation. SFTs that do not comply with the minimum level of collateralisation would be subject to a more conservative capital requirement against counterparty credit risk, i.e. treated as unsecured loans to the respective counterparty (in other words, the mitigating effect of any collateral received would not be recognised). The introduction of minimum haircut floors in the Basel framework would limit the amount that non-banks can borrow against different categories of securities. This in turn, should restrain the build-up of excessive leverage outside of the banking system and reduce the procyclicality of that leverage. An alternative option recommended by the Financial Stability Board (FSB) in 2015[19] to meet these prudential objectives would be to introduce minimum haircut floors for in-scope SFTs via a market regulation. In this case, institutions would no longer be allowed to conduct those SFTs below the minimum haircut floors. A market regulation would ensure a level-playing field for all market participants should the Union decide in the future to introduce a similar market regulation for in-scope SFTs between non-banks, as also recommended by the FSB.

Questions:

112) How do you view the potential effectiveness of minimum haircut floors with regard to achieving their prudential objectives? Would the incentive provided by the framework be sufficient to encourage institutions to meet the minimum level of over-collateralisation?

113) Would the introduction of minimum haircut floors particularly affect certain types of in-scope SFTs or certain counterparties with which institutions conduct in-scope SFTs? If so, which effects would you expect and how could prudential regulation address them?

114) Would you deem further clarifications necessary, for instance, concerning the scope of application of the framework or the formulas that identify in-scope SFTs non-compliant with the minimum haircut floors? If yes, please specify.

115) As an alternative option to implementing minimum haircut floors for in-scope SFTs in the prudential framework as provided by the Basel III standards, such floors could be implemented via a market regulation. How would you compare the two alternative options in terms of achieving the prudential objectives? Would one of the two options affect more significantly the SFTs market? Please provide relevant evidence to substantiate your views.

116) In your view, which other aspects, if any, should be considered in the context of the possible implementation of minimum haircut floors in the Union? Please specify and provide relevant evidence.

[19] https://www.fsb.org/wp-content/uploads/P190719-1.pdf

2.2. OTHER REVISIONS TO THE CALCULATION OF THE EXPOSURE AT DEFAULT FOR SFTS

Issue: The final Basel III standards revised some methods to calculate the exposure value for counterparty credit risk (CCR) arising from SFTs. The main changes include (i) the recalibration of supervisory haircuts; (ii) the removal of the use of own estimates of collateral haircuts and (iii) amendments to the formula for the calculation of the exposure value of SFTs covered by a master netting agreement. In addition, the 'Repo-VaR' approach (internal models approach for master netting agreement under CRR) would no longer be permitted where institutions use the Standardised Approach for Credit Risk to assess the risk weights of their counterparties. Some of these revisions seek to enhance the risk-sensitivity of the methods used to calculate the SFTs exposure value for CCR. Others simplify these methods and improve the comparability across institutions. Incorporating the amendments into Union law would require a number of limited amendments to the CRR.

Questions:

117) What are your views on the expected effects of these revisions with regard to risk-sensitivity, recognition of netting, impact on RWAs and comparability across institutions? Please provide relevant evidence to substantiate your views.
118) Would these revisions particularly affect certain types of SFTs or counterparties with which institutions conduct SFTs? Please support your view with specific evidence to the extent possible.
119) Would you face any operational burden to implement these revisions, particularly those revisions restricting the use of internal modelling? If so, please elaborate on the possible change and its underlying reasons.
120) In your view, which other aspects, if any, should be considered in the context of implementing the revisions to the calculation of the exposure value for SFTs in the counterparty credit risk framework? Please specify and rank your answers from the most important to the least important aspect.

2.3. IMPLEMENTATION CHALLENGES AND ADMINISTRATIVE BURDEN

Questions:

121) Which revisions related to SFTs, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.
122) Which revisions related to SFTs, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

3. OPERATIONAL RISK

3.1. DISCRETION TO SET THE ILM EQUAL TO 1

Issue: The Basel III standards introduce a new standardised approach for operational risk (SA-OR) that combines a refined measure of gross income (Business Indicator, BI) with an institution's own internal loss history over 10 years (Internal Loss Multiplier, ILM). The ILM is based on the assumption that institutions that have experienced greater operational risk losses historically are more likely to experience operational risk losses in the future. By default, all institutions with a BI that exceeds EUR 1 billion ("bucket 2" and "bucket 3" institutions) have to use an institution-specific ILM for calculating their operational risk regulatory capital. Supervisors may however exercise their discretion to neutralise the ILM for all institutions in their jurisdiction (i.e. set the ILM to 1). Institutions that encountered above-average losses in the past would then not be subject to higher own funds requirements while institutions with a more benign loss history would not be rewarded with a capital relief.

Questions:

123) How would exercising the discretion affect the link between capital incentives and management of operational risks? Please elaborate.

124) Would you deem it necessary to mitigate possible cliff effects that might derive from the introduction of an institution-specific ILM? If so, which measures should be considered, for how long should they be applicable, and what would be the prudential rationale to implement them? Please elaborate.

3.2. DISCRETION TO INCREASE THE LOSS DATA THRESHOLD TO EUR 100,000

Issue: According to the Basel III standards, the loss history of an institution has a direct impact on its operational risk capital calculations, if an institution-specific ILM is applied. A proper identification and collection of relevant loss events is thus an important precondition to the capital calculation under the standardised approach. The minimum threshold for including a loss event in the data collection and calculation of average annual losses was set at EUR 20,000. Supervisors may however increase this threshold to EUR 100,000 for individual bucket 2 and 3 institutions in order to, for instance, tailor the operational risk framework to the heterogeneous risk profiles of the institutions.

Questions:

125) What are your views on how a loss data threshold that is increased for some institutions may affect the soundness and risk-sensitivity of the operational risk framework, the volatility of the ILM, its comparability between institutions, and the incentive to carefully manage small to medium-sized losses? Please specify your views.

126) If the discretion was retained, which conditions and criteria should be introduced in order to ensure a level playing field in its application by supervisors? Please elaborate.

127) Which threshold (EUR 20,000 or EUR 100,000) would better reflect the current threshold used for your loss data collection? Please elaborate and provide relevant evidence.

3.3. DISCRETION TO USE THE ILM FOR BUCKET 1 INSTITUTIONS

Issue: In contrast to bucket 2 and 3 institutions, internal loss data does not affect the calculation of operational risk capital for bucket 1 institutions (i.e. with BI ≤ EUR 1 billion) as their calculations rely on BIC only. Institutions in bucket 1 may however apply to use their institution-specific ILM, if their loss data collection meets the relevant requirements.

Questions:

128) What are your views on how this discretion might affect the overall level of own funds for operational risk of bucket 1 institutions and the comparability within bucket 1? Please elaborate your views.

129) If the discretion was retained, which conditions and criteria should be introduced in order to ensure a level playing field in its application by supervisors? Please elaborate.

130) If the discretion was retained, do you consider this could help smoothing the transitioning of institutions from Bucket 1 to Bucket 2? Please elaborate.

3.4. DISCRETION TO REQUEST INSTITUTIONS TO USE LESS THAN FIVE YEARS WHEN THE ILM IS GREATER THAN 1

Issue: Institutions are required to have ten years of high quality annual loss data to calculate their Loss Component, which is reduced to 5 years for institutions that transition to the standardised approach. Supervisors may require institutions to use less than five years of losses (as opposed to ILM=1), but only if the ILM is greater than 1 and supervisors believe the losses are representative of the institution's operational risk exposure (for instance for newly established institutions).

Questions:

131) What are your views on the discretion for supervisory authorities to request the institutions to use less than 5 years of loss data (when the ILM >1)? In which circumstances would such a request be justified? Please elaborate and provide relevant evidence.

3.5. EXCLUSION OF CERTAIN OPERATIONAL RISK LOSS EVENTS

3.5.1. Materiality threshold

Issue: The SA-OR permits institutions to request supervisors to exclude certain operational loss events from the Loss Component (LC), under certain qualitative conditions (e.g. loss event is not representative of the current operational risk profile) (see paragraphs 27 to 29). Each Basel jurisdiction can determine the materiality threshold for exclusion of loss events (example of 5% of the average annual losses is given in Basel standard).

Questions:

132) What would you consider to be the appropriate thresholds for allowing a request for exclusion of loss events from loss data history, for current and divested activities? Please explain and provide relevant evidence to substantiate your views.

3.5.2. Minimum retention period

Issue: According to the SA-OR, losses can be excluded after being subject to a minimum retention period into the loss dataset, suggesting 3 years as an example.

Questions:

133) What would be in your view an appropriate minimum retention period for the losses that will be excluded from the loss dataset? What would be an appropriate starting point of this period? Please explain and provide relevant evidence to substantiate your views.

3.6. OTHER OPERATIONAL RISK TOPICS

3.6.1. Governance and organisational requirements

Issue: In order to ensure that high standards of operational risk management are maintained at EU level, certain requirements related to governance, reporting and control of operational risk[20] currently contained in the CRR and in the Commission Delegated Regulation 959/2018 (hereinafter: CDR) but not reflected in the new Basel SA, may need to be retained in Level 1 or Level 2 legislation. This concerns specifically the requirements referred to in Articles 320 and 321 CRR and corresponding provisions in the CDR. In relation to the collection of the loss data, the CDR envisages additional (compared to the SA-OR) requirements on the processes and procedures for loss data collection, quality and type of data that should be collected for the loss dataset or otherwise flagged.

Questions:

134) What are your views on retaining the aforementioned CRR provisions and adapting the corresponding CDR provisions with a view to maintain their binding status?

135) Does your institution already comply with the relevant requirements? Please list the requirements that are not currently applicable to your institution and whether there is any additional operational burden associated with achieving compliance.

136) Are there any concerns in terms of proportionality that you would consider important to raise? Which threshold would you consider appropriate for the applicability of the governance and organisational requirements? Please elaborate.

3.6.2. ICAAP and Pillar 2

[20] E.g. the requirements to: have in place a well-documented assessment and management system for operational risk; an independent operational risk management function; regular monitoring and reporting of operational risk exposures and loss experience; routines for ensuring compliance and policies for the treatment of non-compliance; subject operational risk assessment and management processes internal or external auditor reviews, etc

Issue: A majority of the institutions is currently using a quantitative approach for operational risk economic capital, and a minority is planning to rely on the SA-OR for ICAAP purposes. The elements most commonly used by institutions in employing quantitative approaches for determining their economic capital for operational risk as part of the ICAAP are internal loss data, followed by scenarios, external loss data and key risk indicators.[21] The SA-OR only requires internal loss data.

Questions:

137) What are your views on requiring the inclusion of the abovementioned elements (internal loss data, scenarios, external loss data and key risk indicators) in the ICAAP for operational risk? Please explain your reasoning in case of disagreement (separately for each element).

138) Would you deem further refinements or clarifications necessary concerning the ICAAP for operational risk, and if yes, what would those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

139) What threshold would you consider appropriate for the applicability of the aforementioned ICAAP requirements for Pillar 2? Please elaborate.

3.6.3. Identifying BIC items in Financial Reporting (FINREP)

Issue: The items for calculating the BIC component are based on income statement and balance sheet data. However, the SA-OR does not provide details and does not cater for differences in accounting statements across Basel jurisdictions. In the EU, however, the rows and/or columns of the relevant tables in FINREP templates may serve as a reference for a harmonised identification of BIC items, including in Member States that use national Generally Accepted Accounting Principles (GAAP).

Questions:

140) What are your views on the costs and benefits of using FINREP templates as a reference for a harmonised identification of BIC items in the EU? Please substantiate your views with relevant evidence.

141) What are your views on introducing a mapping table via Level 2 measures to allow for timely updates in case the corresponding FINREP standards change? Please elaborate.

142) In your view, which other aspects, if any, should be considered in the context of mapping BIC components and FINREP items? Please elaborate.

3.7. OTHER PROVISIONS

Questions:

143) In your view, which other aspects, if any, should be considered in the context of revising the operational risk framework? Please elaborate and rank your answers from the most important to the least important aspect.

[21] See paragraph 139 of the EBA's "Policy Advice on the Basel III reforms: Operational Risk".

3.8. IMPLEMENTATION CHALLENGES AND ADMINISTRATIVE BURDEN

Questions:

144) Which elements of the revised SA-OR, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

145) Which elements of the revised SA-OR, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

4. MARKET RISK

4.1. CONVERTING THE REPORTING REQUIREMENT INTO AN OWN FUNDS REQUIREMENT

Issue: As a first step, EU co-legislators agreed to implement in the CRR the new market risk standards published by the BCBS in 2016 (so-called "FRTB framework") as a reporting requirement. Reporting on market risk in accordance with the FRTB framework will start once the revised elements of the FRTB framework, finalised by the BCBS in 2019, are incorporated in Union law (by means of a delegated act for the elements of the standardised approach (SA-MR) and by means of regulatory technical standards and guidelines developed by the EBA for the elements of the internal model approach (IMA)). As a second step to finalise the implementation of the FRTB framework in the Union, the Commission services are now assessing how to appropriately convert the FRTB reporting requirement under CRR into a binding own funds requirement.

Questions:

146) What considerations should be taken into account regarding the implementation of the revised trading book boundary? Please specify and provide relevant evidence to substantiate your views

147) What considerations should be taken into account in implementing any other revised elements of the FRTB framework, finalised by the BCBS in 2019? Please specify and provide relevant evidence to substantiate your views

4.2. INTRODUCTION OF THE SIMPLIFIED STANDARDISED APPROACH

Issue: The Basel III standards introduce a new SA-MR, which is more risk sensitive than the Basel 2.5 SA-MR, with the aim to act as a credible backstop to the new IMA. At the same time, the BCBS acknowledged the operational challenge posed by the implementation and the maintenance of the Basel III SA-MR, as in particular institutions with medium-sized trading books might not require the level of sophistication introduced by the Basel III SA-MR due to their more limited market risks. Therefore, the BCBS allows such institutions to use the existing, simpler SA-MR under the Basel 2.5 framework as an alternative for calculating their own funds requirement for market risk. At the same time, the BCBS agreed to recalibrate this "simplified" SA-MR to ensure a sufficiently conservative calibration of own funds requirements for these institutions, better aligned with the revised calibration of the market risk framework. To this end, different scalars have been applied to the different RWs for asset class under the simplified SA-MR.

Questions:

148) What are your views on the introduction of the simplified SA-MR, in particular the revised calibration proposed by the BCBS? What would be the impact on RWAs and which types of activities or transactions, if any, would be particularly affected by the revised calibration? Please provide relevant evidence to substantiate your views.

4.3. TREATMENT OF INVESTMENTS IN COLLECTIVE INVESTMENT UNDERTAKINGS (CIUS)

Issue: Compared to the original FRTB standards published in 2016, the final Basel III standards contain several revisions to the treatment of market risks emanating from investments in CIUs. First, the conditions for the eligibility of CIUs to be allocated to the trading book have been relaxed. Second, a number of approaches have been designed in the trading book to calculate the own funds requirements for CIUs):

- The IMA would only be allowed where a look-through is possible. Under this approach, institutions would have to consider the CIU as a portfolio of its underlying instruments.
- The SA-MR may be used where either (i) a look-through is possible or (ii) the mandate of the fund is available and daily price quotes can be obtained. In the first case, institutions have to consider the CIU as a portfolio of its underlying assets for the calculation of the capital requirement under the SA. In the second case, three different approaches are possible: first, a preferential treatment for funds tracking an index benchmark, second the creation of a hypothetical portfolio which is based on the mandate of the CIU and subject to supervisory approval (the "mandate-based approach"), and third treating the investment as an unrated equity exposure (the so-called "single equity approach").

Questions:

149) What are your views on the costs and benefits of implementing the conditions provided by the Basel III standards for allocating investment in CIUs to the trading book? Please provide relevant evidence to substantiate your views.

150) What are the proportion and characteristics of the CIUs where a look-through is possible and how frequent is this possible? Please provide relevant evidence.

151) What are the proportion and characteristics of the CIUs traded in the EU for which the mandate of the CIU is available and daily price quotes can be obtained? Please provide relevant evidence.

152) Would you consider that the revised conditions for the application of the IMA for CIUs would significantly affect investments in those instruments? If yes, would there be any solutions to address this issue prudentially? Please explain and provide relevant evidence.

153) Would you consider that the revised approaches for calculating the own fund requirements for CIUs in the SA-MR would significantly affect investments in those instruments? If yes, would there be any solutions to address this issue prudentially? Please explain and provide relevant evidence.

154) What are your views in relation to the conditions and approaches under the Basel III SA-MR for the treatment of CIUs? In particular, how do the approaches compare in terms of operational burden? Please elaborate and provide relevant evidence to substantiate your views.

4.4. DATE OF APPLICATION OF NEW OWN FUNDS REQUIREMENTS FOR MARKET RISK

Issue: The BCBS agreed on the 1 January 2022 as the date of application of the final Basel III standards including for market risk. Based on the current EU legislation in force, it can be expected that institutions will become subject to the new reporting requirement based on the Basel III SA-MR in the first quarter of 2021. It can also be expected that the reporting of the own

funds calculations in relation to the IMA under Basel III will not commence before the third quarter of 2023. This longer timeframe for the IMA would allow for sufficient time for the EBA to develop the regulatory technical standards introducing the revised quantitative requirements for using the IMA and for supervisors to take all the necessary steps to properly implement and approve the new market risk models.

Questions:

155) Views are sought regarding the date of application of the new own funds requirements for market risk. Taking into account the time needed for the legislative process to implement the new own fund requirements for market risk in the EU and the time-consuming model approval process, which date would you consider appropriate for the application of the FRTB framework as a binding own fund requirements in the Union?

4.5. OTHER PROVISIONS

Questions:

156) In your view, which other aspects, if any, should be considered in the context of revising the market risk framework? Please specify and rank your answers from the most important to the least important aspect.

4.6. IMPLEMENTATION CHALLENGES AND ADMINISTRATIVE BURDEN

Questions:

157) Which elements/revisions of the SA-MR and, respectively, IMA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the expected one-off costs to substantiate your views.

158) Which elements/revisions of the SA-MR and, respectively, IMA, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

5. CREDIT VALUATION ADJUSTMENT (CVA) RISK

5.1. REVISED CVA FRAMEWORK

Issue: The final Basel III standards remove the use of an internally modelled approach for CVA risk and provide two standardised approaches: a more complex approach, termed 'standardised approach' (SA-CVA) and a relatively simpler approach termed 'basic approach' (BA-CVA). The SA-CVA builds on the Basel III market risk framework by using fair value sensitivities to market risk factors of a principle-based definition of CVA. The BA-CVA builds on the current standardised method for CVA risk. In addition, the final Basel III standards enhanced the risk sensitivity of the CVA framework by taking into account the exposure component of CVA risk along with its associated hedges while the previous CVA framework currently implemented in the EU captures only the credit spread risk of CVA.

Questions:

159) Views are sought on the cost and benefits of implementing the revised CVA framework in the EU. In particular, how do the approaches provided by the final Basel III standards compare with the current approach of the CRR in terms of impacts on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

160) Would in your view any type of transactions be particularly affected by the implementation of the revised CVA framework in the Union? Please provide relevant evidence to substantiate your views.

161) One of the main objectives of the final Basel III standards was to enhance the risk-sensitivity of the CVA framework. Are there in your view elements of the approaches of the revised CVA framework that do not achieve these objectives? If yes, which ones and what are the potential solutions to address them prudentially? Please provide relevant evidence to substantiate your views.

162) The final Basel III standards extend the scope of CVA risks subject to the framework. In this context, what are your views on the capacity of institutions in the EU to manage and hedge all CVA risks? Are CVA hedges under the SA-CVA and BA-CVA appropriately recognised? If not, what are the potential solutions to better recognise them prudentially? Please provide relevant evidence to substantiate your views.

163) Would you see particular challenges to implement the Basel III standards on CVA risk by the internationally agreed deadline, and if yes, why? Please elaborate.

5.2. EXEMPTIONS UNDER THE CRR

Issue: Similarly to the initial Basel III standard on CVA risk published in 2011, the final Basel III standards do not exempt any particular transactions from the calculation of the capital requirement for CVA risk. By contrast, the CRR provides a number of exemptions from the CVA framework, mostly covering derivative transactions with counterparties that were exempted from the clearing/margining mandates under Regulation (EU) No 648/2012 (EMIR) (certain non-financial, sovereign, intra-group and pension fund counterparties), with the aim to prevent a potentially excessive increase in the cost of derivative transactions for those counterparties due to the introduction of the own funds requirements for CVA risk. However, the

CVA risk of the exempted counterparties under the CRR may still be a source of significant risk for some of the institutions that benefit from those exemptions.

Questions:

164) How do institutions currently manage the CVA risks arising from the counterparties exempted from the current CVA framework under CRR? Please provide relevant evidence to substantiate your views.

165) What would you consider to be the potential impacts on RWAs and in terms of operational burden stemming from removing the existing exemptions under the CRR would have? Please provide relevant evidence to substantiate your views.

166) In your view, which clarifications, if any, should be provided regarding the definition of the current exemptions, should these exemptions be retained under the CRR? Please provide relevant evidence to substantiate your views.

5.3. PROPORTIONALITY IN THE CVA FRAMEWORK

Issue: According to the final Basel III standards, institutions with an aggregate notional amount of non-centrally cleared derivatives lower than or equal to €100 billion may calculate their own funds requirements for CVA risk as a simple multiplier of their own funds requirements for counterparty credit risk. This simplified approach for CVA risks was introduced to provide institutions with smaller derivatives portfolios with a simple alternative to the revised CVA framework.

The CRR introduced simplified standardised approaches for counterparty credit risk subject to certain eligibility criteria based on the market or fair-value of derivative transactions instead of notional values (Article 273a).

Questions:

167) Views are sought on the costs and benefits of the simplified approach provided by the Basel III standards to calculate the own funds requirements for CVA risks. In particular, what would be the impact in terms of RWAs and operational burden? Please provide relevant evidence to substantiate your views.

168) Would you consider a simple multiplier applied to the own funds requirements for counterparty credit risk to provide an appropriate proxy for determining the own funds requirement for CVA risks of institutions with smaller derivatives portfolios, and if not, what would be a better proxy to measure those risks? Please provide relevant evidence to substantiate your views.

169) Views are sought on the appropriateness of the EUR 100 billion threshold for allowing institutions to use the simplified approach. How would this threshold compare to the eligibility criteria for the use of the existing simplified approach to calculate the own funds requirements for CVA risks under Article 385 of the CRR? How would the EUR 100 billion threshold compare to the eligibility criteria for the use of the simplified methods to calculate the exposure value for counterparty credit risk under Article 273a CRR? Please provide relevant evidence to substantiate your views.

5.4. INTERNAL CVA UNDER THE SA-CVA

Issue: Under the most risk sensitive approach provided by the Basel III standards, the SA-CVA, institutions are allowed to internally model CVA sensitivities in order to calculate the own fund requirements for CVA risks. This internal CVA has to meet a number of principles, aligned with common assumptions used by institutions to model CVA for accounting purposes (‘accounting CVA’), and must be approved by supervisors.

Questions:

170) What are your views on the principle-based definition of internal CVA sensitivities under the SA-CVA? Would these principles be aligned with the accounting CVA? Would these principles create undesirable effects or excessive operational burden if not aligned with these principles used for the accounting CVA? What would be the potential solutions to address those misalignments? Please elaborate and provide relevant evidence to substantiate your views.

171) In your view, what considerations should be taken into account in the supervisory permission process set up to approve internal CVA under the SA-CVA?

5.5. FAIR-VALUE SFTS UNDER THE CVA FRAMEWORK

Issue: The revised CVA risk framework requires institutions to calculate an own funds requirement for CVA risk for SFTs measured at fair-value for accounting purposes.

Questions:

172) What are your views regarding the inclusion of fair-valued SFTs in the scope of the revised CVA framework in terms of impacts on RWA and operational burden? Please provide relevant evidence to substantiate your views.

173) Which portion of institutions’ SFTs portfolios is fair-valued for accounting purposes and according to which accounting standards? What are the features of those SFT transactions? Would the introduction of those SFTs in the scope of the revised CVA framework particularly affect those activities? Please elaborate and provide relevant evidence to substantiate your views.

5.6. OTHER PROVISIONS

Questions:

174) In your view, which other aspects, if any, should be considered in the context of revising the CVA framework? Please specify and rank your answers from the most important to the least important aspect.

5.7. IMPLEMENTATION CHALLENGES AND ADMINISTRATIVE BURDEN

Questions:

175) Which elements of the revised CVA framework, respectively, IMA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the expected one-off costs to substantiate your views.

176) Which elements of the revised CVA framework, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

6. OUTPUT FLOOR (OF)

6.1. MATERIAL SCOPE OF APPLICATION

Issue: The OF introduced by the Basel III standards intends to ensure that institutions' own funds requirements do not fall below 72.5% of the own funds requirements derived under the standardised approaches. More specifically, the floor applies to institutions' calculations of RWAs which in turn are to be used for the calculation of the applicable own funds requirements in order to reduce excessive variability of RWAs and to enhance the comparability of risk-based capital ratios. In terms of own funds requirements that need to be calculated on the basis of floored RWAs, the Basel III standards refer to the Pillar 1 requirements, the capital conservation buffer requirement, the countercyclical capital buffer requirement, as well as the buffer requirements for global systemically-important and, respectively, other systemically-important institutions (G-/O-SIIs) and the total loss-absorbing capacity (TLAC) requirements. However, in addition to the above-listed requirements, the risk-based capital framework in the EU currently also includes the systemic risk buffer (SRB) and Pillar 2 requirements (P2R).

Questions:

177) What are your views on the relative costs and benefits of including in the calculation of the OF more own funds requirements than those explicitly mentioned in the Basel III standards? In particular, how would such broader material scope compare to the scope required by the Basel III standards in terms of impact on RWAs, risk-sensitivity, comparability, complexity and operational burden? Please provide relevant evidence to substantiate your views.

178) Would you deem further refinements or clarifications necessary concerning the material scope of the OF, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

6.2. LEVEL OF APPLICATION

Issue: The Basel III standards do not specify the level of application of the OF.

Questions:

179) Views are sought on the relative costs and benefits of applying the OF at all levels of the banking group (i.e. individual, sub-consolidated and consolidated) or solely at the highest level of consolidation in the EU. In particular, how do the two approaches compare in terms of impact on RWAs, comparability, complexity and operational burden? Please provide relevant evidence to substantiate your views.

180) In your view, how would the two approaches affect the internal risk allocation across banking groups, in particular those with specific group structures or business models at subsidiary level? Please elaborate and provide relevant evidence.

181) What other solutions or safeguards could be envisaged as alternatives to your preferred approach? Please elaborate and provide relevant evidence.

6.3. TRANSITIONAL MEASURES

Issue: The Basel III standards foresee a 5-year transitional path for institutions to grow into and adjust to the new requirement, as well as the possibility of a "transitory cap" that temporarily prevents that RWA increase more than 25% because of the OF.

Questions:

182) In your view, should both of the transitional measures provided by the Basel III standards be implemented in the EU, and if not why?

183) Would you deem further refinements or clarifications necessary concerning the transitional measures, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

184) In your view, what measures, if any, should be taken to ensure a smooth implementation of the OF? Please elaborate and provide relevant evidence.

6.4. OTHER PROVISIONS

Questions:

185) In your view, which other aspects, if any, should be considered in the context of implementing the OF? Please elaborate and rank your answers from the most important to the least important aspect.

6.5. IMPLEMENTATION CHALLENGES AND ADMINISTRATIVE BURDEN

Questions:

186) Which elements of the OF, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the expected one-off costs to substantiate your views.

187) Which elements of the OF, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

7. CENTRALISED SUPERVISORY REPORTING AND PILLAR 3 DISCLOSURES

Issue: The BCBS completed the standards on Pillar 3 disclosure requirements in December 2018. They accompany the finalised Basel III reforms of December 2017. Most of the updated Pillar 3 disclosure requirements have been implemented in the EU as part of the recent review of the CRR/D. As in the case of supervisory reporting requirements, EBA is mandated to develop implementing technical standards for disclosures.

Under the current framework, institutions need to process the same data according to two separate schemes: one for supervisory reporting and one for disclosures. As regards the latter, the CRR requires institutions to disclose all the information in one single document or a separate section of the financial report (Article 434). The Fitness Check on Supervisory Reporting[22] and the Call for Evidence[23] EU regulatory framework for financial services conducted by the Commission clearly identified that institutions consider reporting and disclosure requirements as important cost factors. Therefore it is important that the framework for reporting and disclosure does not cause undue burden. This is likely to be particularly relevant for non-complex and other institutions (than large ones) as defined in point (145) of Article 4(1) of the CRR.

Taking into account the similar content of technical standards on supervisory reporting and disclosures and to ensure coherence of the information to be reported and disclosed, respectively, the EBA established a single process for developing supervisory reporting and disclosure standards. Since 2018 the EBA in cooperation with the European Central Bank and national competent authorities (NCAs) has been working to create the European Centralised Infrastructure for Supervisory Data (EUCLID).[24] It is expected that from end-2020 the EBA will collect supervisory data from all institutions as opposed to the current sample consisting of around 200 large institutions.

Questions:

188) Once EUCLID is fully implemented, would you support that the EBA, on the basis of the collected supervisory data from all institutions established in the Union, centrally discloses the information of all those institutions that are subject to disclosure requirements under CRR/D, thereby relieving institutions from mandatory disclosures?

189) If you support centralising disclosures at the EBA, please explain

i) whether in your view stakeholders (investors, etc.) would have the benefit in accessing disclosures of all institutions in one internet place?

ii) whether in your view a single location policy should be applicable to all type of institutions: small non-complex, large and other institutions?

iii) how responsibilities for the disclosed information should be shared between institutions, competent authorities and the EBA?

190) If you do not support centralising disclosures at the EBA, please explain why.

[22] Public consultation on fitness check on supervisory reporting, available at: https://ec.europa.eu/info/consultations/finance-2017-supervisory-reporting-requirements_en.

[23] Call for evidence: EU regulatory framework for financial services, available at: https://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm.

[24] For more information on EUCLID, see page 70 of the EBA's "Annual Report 2017", available at https://eba.europa.eu/documents/10180/2255336/2017+EBA+Annual+Report.pdf.

8. Sustainable finance

Issue: In the context of the last CRR/D review, co-legislators reflected on the Paris Agreement on climate change and its impact on prudential regulation and agreed on three actions dedicated to sustainable finance:

- a mandate for the EBA to assess the inclusion of environmental, social and governance (ESG) risks in the supervisory review and evaluation process (SREP) and submit a report on its findings to the Commission, the European Parliament and to the Council; on the basis of the outcome of its report, the EBA may, if appropriate, issue guidelines regarding the uniform inclusion of ESG risks in the SREP (Article 98(8) CRD);
- a requirement for large, listed institutions to disclose ESG risks, including physical risks and transition risks (Article 449a CRR);
- a mandate for the EBA to assess on the basis of available data and the findings of the Commission High-Level Expert Group on Sustainable Finance, whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified (Article 501c CRR).

Further to this work, the Commission has launched a study on the development of tools and mechanisms for the integration of ESG risks into institutions' risk management, business strategies and investment policies as well as into prudential supervision.[25] Final results of this study are expected for beginning of 2021.

As part of its Action Plan on Sustainable Finance[26], the Commission proposed a regulation[27] for a framework for the establishment of an EU classification of environmentally sustainable economic activities (so-called "EU taxonomy"). In parallel, the Commission set up a technical expert group on sustainable finance (TEG)[28] that was tasked to already advice on a taxonomy for climate change mitigation and adaptation. While the negotiations on the legislative proposal are still ongoing, the TEG has in the meantime published its report[29].

Questions:
191) In your view, which further measures, if any, could be taken to incorporate ESG risks into prudential regulation without pre-empting ongoing work as set out above? Please elaborate and provide relevant evidence to substantiate your view.

[25] See https://etendering.ted.europa.eu/cft/cft-display.html?cftId=5201.
[26] For further information see https://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en.
[27] COM(2018) 353 final, Brussels, 24.5.2018.
[28] For further information see https://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en.
[29] Available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-taxonomy_en.pdf.

9. FIT AND PROPER

9.1. KEY FUNCTION HOLDERS

The Capital Requirements Directive (CRD) includes some provisions on the role of competent authorities in the assessment of the suitability of members of the management body. It does not, however, provide for assessment by competent authorities of the suitability of other individuals holding positions of responsibility.

The Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders ("the Joint ESMA/EBA Guidelines") go further. They specify that, for significant CRD-institutions, competent authorities should also assess the suitability of some key function holders (as defined in the guidelines), namely the heads of internal control functions and the chief financial officer (CFO), where they are not members of the management body.

Competent authorities do not, however, always comply with this point of the guidelines. Where they do, the criteria on which the assessment is based vary widely. Given, however, that key function holders play a pivotal role in ensuring the sound and prudent management of institutions, it is important that their suitability be assessed in a consistent way.

With a view to ensuring greater consistency in the approach adopted by competent authorities and to remove possible scope for ambiguity in the current provisions it is important to reflect on the need to expand, in the CRD, the scope of competent authorities' role in fit and proper assessment to include the assessment of some key function holders.

Questions:

192) What would be the benefits and drawbacks of including the requirement for competent authorities to perform a fit and proper assessment of at least some key function holders in the CRD?

193) In your view, would it be useful to identify key function holders in a descriptive manner, and/or to specify certain roles as belonging, by default, to the set of key function holders? Please consider the practical implications of each option and the need for clarity and consistent application across institutions and competent authorities. Please elaborate and provide evidence.

194) Were the CRD to specify a number of roles that would be considered, by their very nature, to be occupied by key function holders, which specific roles should, in your view, be included in this list?

195) Views are also sought as to whether the scope of key function holders subject to fit and proper assessment should be limited to those holding these positions at group level or whether it should also include key function holders at the level of each institution? Please elaborate and provide evidence.

196) Should the key function holders be subject to fit and proper assessments by competent authorities, on what criteria could this assessment be performed?

9.2. COMPETENT AUTHORITIES' ASSESSMENT OF THE SUITABILITY OF MEMBERS OF THE MANAGEMENT BODY

9.2.1. Supervisory procedure

9.2.1.1. Ex ante and ex post approval and ex post notification

The CRD provides substantive rules and guidance on fit and proper requirements but does not prescribe the type of procedure to follow. Competent authorities are therefore free to choose whether to apply an *ex ante* or an *ex post* approval procedure when assessing the suitability of members of the management body, which leads to significant variation in practices. This triggers, for example, situations where unsuitable individuals occupy highly influential positions only for it later to emerge that they fail the fit and proper criteria, at which point it can be difficult to remove them.

With a view to having more consistent practices and avoiding situations where the suitability of individuals is put into questions at too late a stage, it is important to reflect on the need to introduce in the CRD a requirement with a consistent approach to conducting the assessment, for example by having an *ex ante* procedure.

Questions:

197) Please explain what you consider to be the advantages and disadvantages of competent authorities conducting ex ante and ex post approval, respectively, of suitability of members of the management body.
198) If, in your jurisdiction, institutions are required to request approval for the appointment of members of the management body only after they take up their position, please explain what, if anything, would make it difficult for you to adapt to an ex ante system.
199) One issue that has been raised in the past in relation to ex ante assessment is avoiding vacant positions on the board. Please explain, based on your experience, to what extent this can be overcome (if it is an issue in the first place) giving examples and making reference where appropriate to succession planning and procedures in place for identifying skills/experience that could be particularly difficult to replace.
200) Which specific positions within the board and/or senior management of institutions do you believe should be considered as part of an ex ante assessment, given the responsibilities they hold and the risks they may pose? Please provide evidence and/or examples to support your views.

9.2.1.2. Processing of applications for fit and proper approval

The Joint ESMA/EBA Guidelines state that competent authorities should, as a rule, complete the fit and proper assessment within a maximum period of four months (or up to six months if there are suspensions when the competent authority is awaiting information requested from the institution). The implications of this deadline are clearly different according to whether the assessment is being conducted *ex ante* or *ex post*. If the CRD were to include a requirement for competent authorities to assess at least some members of the management body (and key function holders) *ex ante*, it is important to reflect on whether additional certainty could be given to institutions by also including provisions on the timelines for assessment by competent authorities in the CRD.

Questions:

201) Considering a scenario in which at least some fit and proper assessments were to be conducted by competent authorities ex ante, what would be, for you, the costs and benefits of a deadline for the assessment of proposed board members being set in the CRD? What would you consider a reasonable period of time for the assessment?
202) Do you currently use, or have you envisaged, other timelines for approval, e.g. whereby institutions only have a limited time to provide the additional information requested, or where the length of the assessment period depends on the specific type of position? If so, please explain the rationale for these timelines.
203) If competent authorities had a fixed time period for giving their approval to proposed new board appointments, would you nonetheless consider it preferable for a decision to be issued in cases where the competent authority decides to approve a candidate? Could you instead envisage a system of "tacit approval" (i.e. whereby, if no decision has been issued by the deadline, the institution can consider the candidate approved)?

9.2.2. Proportionality

The Joint ESMA/EBA Guidelines define significant CRD-institutions for the purpose of fit and proper assessments as including: i) global systemically important institutions, ii) other systemically important institutions, and iii) other CRD-institutions "as determined by the competent authority or national law, based on an assessment of the institutions' size and, internal organisation, and the nature, scope and complexity of their activities".

The concept of proportionality already applies to the requirements for "fit and proper" assessment, but may need to be expanded upon depending on the other possible changes as set out above. In particular, if competent authorities are to be required to conduct fit and proper assessments of key function holders (in addition to the members of the management body) and/or to conduct some of these assessments *ex ante*, it would be important to reflect on the need to have specific provisions on proportionality. For example, this could mean having a differentiated approach depending on the size and the risk profile of the institution (e.g. *ex ante* assessment for members of the management body and key function holders for large/significant institutions) and/or depending on the sensitivity of the roles and positions (e.g. CEO, executive directors, Chair of the board or committees or heads of internal control functions always being assessed by competent authorities).

Questions:

204) Should the scope and format of fit and proper assessments be adapted to take into account the principle of proportionality, including in relation to any new provisions such as those discussed in Sections 9.2.1.1. and 9.2.1.2.? Please elaborate on your reply and provide examples.
205) What specific criteria would you consider appropriate as a basis for allowing some degree of proportionality in the fit and proper assessment, including in relation to any new provisions such as those discussed in Sections 9.2.1.1 and 9.2.1.2? Views are also sought on the possibility of granting competent authorities the right to apply supervisory judgement to enlarge the scope of their assessment based on the risk profile of the institution/role.

206) What specific risks do you see in allowing some degree of proportionality in the application of any new provisions, such as those discussed in Sections 9.2.1.1. and 9.2.1.2., on the timing of the approval of board members by competent authorities and of key function holders?

9.2.3. Roles on the management body, individual and collective suitability

The Basel Guidelines on Corporate governance principles for banks ("the Basel Guidelines") state that the management board in its supervisory function[30] should hold members of the management board in its management function[31] accountable for their actions, and that board members' knowledge, skills and experience should be assessed "given their responsibilities". At present, the responsibilities of the board as a whole are set out in CRD, in the Joint ESMA/EBA Guidelines and in the EBA Guidelines on Internal Governance, but not those of individual members.

In its paper *Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors* ("the FSB Toolkit"), the FSB observes that "accountability can be reinforced by clearly identifying key responsibilities and assigning them to individuals", and explains that such a system can mitigate the risk of misconduct. The FSB Toolkit further describes the types of roles and responsibilities that could be identified, how they can be assigned, and how this process can facilitate the assessment of individuals' suitability for their designated roles.

With a view to strengthening the accountability of members of the management body, it is important to reflect on whether the CRD could incorporate these ideas by including a requirement for institutions to clearly define the roles and responsibilities of each member on the management body and key function holders. This could also help make fit and proper assessments, both by institutions and competent authorities, more informed and targeted.

Questions:

207) What would be the benefits and drawbacks of designing an accountability regime whereby the management body of each institution would be required to draw up a statement of responsibilities of each of its members clearly identifying the activities for which they are responsible, beyond the sole responsibilities linked to their membership of specialised committees (e.g. risk committee, remuneration committee)?
208) How might the collective functioning of the board be affected by the introduction of a system where each individual has a defined set of responsibilities? Please consider the possible effects on both individual conduct and the board as a whole (e.g. the impact on the collective responsibility of the board, or on the quality of its discussions).
209) What would be the benefits and drawbacks of designing a similar accountability regime for key function holders (e.g. information on key function holders, their responsibilities, details of the firm's governance and structure)?
210) Would the assessment of individuals proposed for positions on the board or as key function holders be more accurate and/or reliable if the responsibilities the individual would be taking on were clearly defined, including in relation to any new provisions,

[30] Referred to in the Basel Guidelines as "the board".
[31] Referred to in the Basel Guidelines as "senior management".

such as those discussed in Sections 9.2.1.1 and 9.2.1.2?

9.2.4. Cultural factors influencing conduct

The CRD stipulates in Article 98(7) that competent authorities should consider both corporate culture and values, and the ability of members of the management body to perform their duties as part of their review and evaluation of institutions.

The FSB Toolkit develops the idea of corporate culture more extensively and discusses the ways in which cultural factors can influence the risk of misconduct. A clear link is made between an institution's culture, at all levels within the organisation, and the functioning of governance systems. The FSB Toolkit also highlights both the role of management, in setting the "tone at the top", and of supervisory authorities, in monitoring indicators of an institution's culture and the consequences thereof.

In view of this, it is important to reflect on whether the CRD could, in a similar way to the FSB Toolkit, go further in highlighting the importance of culture for an institution's overall governance, and/or could incorporate cultural factors explicitly in fit and proper assessment.

Questions:

211) Do you consider that corporate culture could and should be taken into consideration as part of the fit and proper assessment? If yes, please explain how this could be most effectively achieved.
212) What do you consider would be the benefits of, and/or difficulties encountered in, including the ability to create and promote the organisation's desired culture as part of the "fit and proper" assessment of members of the management body?