



EBA/RTS/2014/13

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# EBA FINAL draft Regulatory Technical Standards

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on the treatment of equity exposures under the IRB Approach  
according to Article 495(3) of Regulation (EU) No 575/2013 (Capital  
Requirements Regulation – CRR)

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# 1. Executive Summary

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Article 495(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) allows competent authorities temporarily to exempt from the internal ratings-based (IRB) treatment certain equity exposures held by institutions as at 31 December 2007. This provision was already included in Article 154(6) of Directive 2006/48/EC (Capital Requirements Directive – CRD) to allow institutions to avoid part of the increase in the capital requirement of the equity exposure class under the IRB approach. The provision is temporary, its application ending in 31 December 2017.

The only difference between the two regimes is the degree of discretion granted to the competent authorities. Whereas under CRD competent authorities were free to grant the exemption and also decide what particular equity exposures would be exempted, the CRR imposes specific conditions on competent authorities that must be met for the exemption to be granted. These final draft RTS lay down these conditions.

These final draft Regulatory Technical Standards (RTS) establish only one condition for the purpose of granting the exemption of IRB treatment for equity exposures. In essence, the final draft RTS allow competent authorities to grant the exemption if it was being applied on the last day of application of CRD. This straightforward approach is justified as follows:

- the impact of any proposed change on the capital requirement of equity exposures held as at December 2007 would be immaterial in most institutions;
- it provides continuity with the former legislative framework and there is no interference with the capital planning made by institutions under the former regulatory regime.

## 2. Background and rationale

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Article 495(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) allows competent authorities temporarily to exempt from IRB treatment certain equity exposures held by institutions as at 31 December 2007. These equity exposures should be treated using the standardised approach (SA). This provision is independent of the permanent exemption of the equity exposure class that is allowed under Article 150(2) of the CRR.

### *Article 495*

#### *Treatment of equity exposures under the IRB Approach*

*1. By way of derogation from Chapter 3 of Part Three, until 31 December 2017, the competent authorities may exempt from the IRB treatment certain categories of equity exposures held by institutions and EU subsidiaries of institutions in that Member State as at 31 December 2007. The competent authority shall publish the categories of equity exposures which benefit from that treatment in accordance with Article 143 of Directive 2013/36/EU.*

*The exempted position shall be measured as the number of shares as at 31 December 2007 and any additional share arising directly as a result of owning those holdings, provided they do not increase the proportional share of ownership in a portfolio company.*

*If an acquisition increases the proportional share of ownership in a specific holding the part of the holding which constitutes the excess shall not be subject to the exemption. Nor shall the exemption apply to holdings that were originally subject to the exemption, but have been sold and then bought back.*

*Equity exposures subject to this provision shall be subject to the capital requirements calculated in accordance with the Standardised Approach under Part Three, Title II, Chapter 2 and the requirements set out in Title IV of Part Three, as applicable.*

*Competent authorities shall notify the Commission and EBA of the implementation of this paragraph.*

*...*

*3. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall afford the exemption referred to in paragraph 1.*

*EBA shall submit those draft regulatory technical standards to the Commission by 30 June 2014.*

*Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.*

This exemption is not new in the solvency framework; Article 154(6) of Directive 2006/48/EC (Capital Requirements Directive – CRD) already provided for this possibility. It was particularly relevant for some institutions with significant equity holdings, given the higher capital requirement of the equity exposure class under the IRB approach compared to the SA. The same deadline was envisaged as under the CRR (31 December 2017).

*Article 154*

...

*6. Until 31 December 2017, the competent authorities of the Member States may exempt from the IRB treatment certain equity exposures held by credit institutions and EU subsidiaries of credit institutions in that Member State at 31 December 2007.*

*The exempted position shall be measured as the number of shares as of 31 December 2007 and any additional share arising directly as a result of owning those holdings, as long as they do not increase the proportional share of ownership in a portfolio company.*

*If an acquisition increases the proportional share of ownership in a specific holding the exceeding part of the holding shall not be subject to the exemption. Nor shall the exemption apply to holdings that were originally subject to the exemption, but have been sold and then bought back.*

*Equity exposures covered by this transitional provision shall be subject to the capital requirements calculated in accordance with Title V, Chapter 2, Section 3, Subsection 1.*

The only difference between the two regimes is the degree of discretion granted to the competent authorities. Whereas under CRD competent authorities were free to grant the exemption and also decide what particular equity exposures would be exempted, the CRR imposes specific conditions on competent authorities that must be met for the exemption to be granted. These conditions are established by these final draft RTS to improve the harmonisation of the rules applied to financial institutions across the EU.

Only one condition has been considered relevant for the purpose of granting the exemption of IRB treatment for equity exposures. In essence, the proposed legal text allows competent authorities to grant the exemption if it was being applied on the last day of application of CRD. This straightforward approach is justified as follows:

- The impact assessment that has been carried out reveals that the impact of any proposed change on the capital requirement of equity exposures held as at December 2007 would be immaterial in most institutions.
- Given that the same provision already existed in the CRD framework, these final draft RTS should allow continuity with the former application of this exemption in Member States. This is reinforced by the fact that no changes are expected regarding the decisions taken by competent authorities under the former regime. Furthermore, any proposed conditions should not interfere with the capital planning made by institutions under the former regulatory regime as far as possible.

Harmonisation of the rules would be limited to the Member States that decided to apply the exemption and only for a limited period of time (until end 2017).

# 3. EBA FINAL draft Regulatory Technical Standards on the treatment of equity exposures under the IRB Approach according to Article 495(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

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**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of XXX**

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the transitional treatment of equity exposures under the IRB Approach according to Article 495(3)**

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to 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<sup>1</sup>, and in particular the third subparagraph of Article 495 (3) thereof,

Whereas:

- (1) There is a need to specify the conditions under which the competent authorities shall be able to exempt from the IRB treatment certain categories of equity exposures held by institutions and EU subsidiaries of institutions in their respective Member State as at 31 December 2007.
- (2) The specification of these conditions should be achieved in a co-ordinated manner that should not disproportionately jeopardize the smooth transition of the national legal orders from the regime established by the transposition of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and

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<sup>1</sup> OJ L 176, 27.06.2013, p. 1.

pursuit of the business of credit institutions<sup>2</sup> and especially of its Article 154 (6), to the new regime established by Regulation (EU) No 575/2013.

- (3) Further, the specification of these conditions should also, to the extent possible, take into account the legitimate expectations of the institutions which were granted the exemption under the former regime.
- (4) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (5) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>3</sup>,

HAS ADOPTED THIS REGULATION:

#### *Article 1*

##### *Conditions to afford the exemption referred to in Article 495(1) of Regulation (EU) 575/2013*

Only those categories of equity exposures that benefited on 31 December 2013 from an exemption, granted in accordance with Article 154 (6) of Directive 2006/48/EC as transposed in the Members States, shall qualify for the exemption from the IRB treatment according to Article 495(1) of Regulation (EU) 575/2013.

#### *Article 2*

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

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

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<sup>2</sup> OJ L 177, 30.06.2006, p.1

<sup>3</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).



Done at Brussels,

*For the Commission  
The President*

*[For the Commission  
On behalf of the President]*

*[Position]*

## 4. Accompanying documents

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### 4.1 Cost- Benefit Analysis / Impact Assessment

#### Problem definition

Article 495(3) of the CRR allows competent authorities temporarily to exempt from IRB treatment certain equity exposures held by institutions as at 31 December 2007. These equity exposures should be treated according to the SA. This provision is independent of the permanent exemption of the equity exposure class that is allowed under Article 150(2) of the CRR.

This exemption is not new in the solvency framework; Article 154(6) of the CRD I already provided for this possibility. It was particularly relevant for some institutions with significant equity holdings, given the higher capital requirement of the equity exposure class under the IRB approach compared to the SA. The same deadline was envisaged as under the CRR (31 December 2017).

The only difference between the two regimes is the degree of discretion granted to the competent authorities. Whereas under CRD I competent authorities were free to grant the exemption and also decide what particular equity exposures would be exempted, the CRR imposes specific conditions on competent authorities that must be met for the exemption to be granted. These conditions are to be established by these RTS to improve the harmonisation of the rules applied to institutions across the EU.

#### Technical options considered

The final proposal contained in the RTS is the maintenance of the *status quo*, i.e. competent authorities may grant the exemption if it was being applied on the first day of application of these RTS on the basis of CRD I. The main reasons behind this decision are:

- The impact assessment carried out reveals that the impact of any proposed change on the capital requirement of equity exposures held as at December 2007 would be immaterial in most institutions.
- Given that the same provision already existed in the CRD I framework, these RTS should allow continuity in the current application of this exemption in Member States. This is reinforced by the fact that no changes are expected regarding the decisions taken by competent authorities under the former regime. Furthermore, any proposed conditions should not interfere with the capital planning made by institutions under the former regulatory regime as far as possible.
- Harmonisation of the rules would be limited to the Member States that decided to apply the exemption and only for a limited period of time (until end 2017).

The option of allowing competent authorities either to narrow or broaden the previous scope of application of the exemption to categories of equity exposures was also considered. However,

given that no changes are expected in the coming years regarding the decisions taken by competent authorities under the former regime (i.e. CRD I), this option was discarded.

### Impact of the proposals

As explained above, one of the main reasons for proposing the *status quo* for the IRB treatment of equity exposures held by institutions as at December 2007 is the limited impact of any proposed modification. This observation derives from the results of a survey conducted across Member States to gather recent information about the significance of the capital requirement of equity exposures in individual financial institutions in the Union. The main results of the exercise are shown in Figure 1 and can be summarised as follows:

- Data has only been collected from the 17 countries that have applied this provision under CRD I.
- With the exception of two countries that have imposed specific restrictions (immaterial portfolios and leverage buyout investments), the exemption has generally been applied to all equity exposures held as at 31 December 2007.
- The share of total equity exposure treated under the SA on the basis of the IRB exemption under Article 154(6) of the CRD I with respect to total credit risk exposure is generally low. For most banks, the ratios remain below the 4% threshold. In terms of risk-weighted exposures, the ratios are slightly higher than their exposure-based equivalents and most banks have their share of equity risk-weighted exposure under the SA below 10%.
- This information is only available for a limited number of banks. Therefore, the total equity exposure treated under the SA has also been analysed as a cap on the potential impact of the IRB exemption. Since there are several provisions that allow the SA treatment of equity exposures, the share of total equity exposure treated under the SA compared to total credit risk exposure can be interpreted as a maximum to the equity exposures potentially subject to the IRB exemption (Article 154(6) of the CRD I).
- The ratio of total equity exposure treated under the SA remains at even lower levels than the equity exposure subject to the IRB exemption. In this case, the exposure-based and risk-weighted exposure-based ratios for most banks are below the 3% and 8% thresholds respectively. Since this information is available for more banks, it can be concluded that their share of equity exposure under the IRB exemption would have been very low.

The impact of a modification of the IRB treatment of equity exposures held by institutions as at December 2007 would therefore be very limited.

Figure 1.: Equity exposures of IRB banks treated under the SA

<b>Data</b>	<b>Total SA equity exposure / Total credit exposure</b>	<b>Total SA risk-weighted equity exposure / Total risk-weighted credit exposure</b>	<b>Total SA equity under IRB exemption / Total credit exposure</b>	<b>Total SA risk-weighted equity exposure under IRB exemption / Total risk-weighted credit exposure</b>
Median	0.60%	1.33%	0.93%	3.48%
Percentile 75	1.19%	4.41%	2.12%	7.79%
Percentile 90	2.55%	8.71%	3.27%	10.39%
Percentile 95	6.55%	15.47%	5.02%	13.49%
Maximum	13.73%	24.24%	8.12%	18.15%
N. banks	32	36	16	16

#### *Costs*

Given that the proposal contained in these RTS is a continuation of the former regulatory regime (i.e. CRD I), there should not be any specific cost either in terms of compliance with the RTS or in terms of increased capital. Regarding the latter, these RTS imply that the capital requirement remains at a lower level than would otherwise be the case under the IRB approach.

#### *Benefits*

For the reasons set out above, it is considered most beneficial to adopt a simple and straightforward approach where the former regulatory regime (i.e. CRD) is maintained.

## 4.2 Views of the Banking Stakeholder Group (BSG)

This section sets out the BSG comments on draft Regulatory Technical Standards (RTS) on the treatment of equity exposures under the IRB Approach under Article 495(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) (EBA/CP/2014/06).

Please note that references to articles of the draft RTS in the feedback statement follow the original numbering of the consultation paper proposal, unless it is directly stated that we refer to these final draft RTS.

### General comments

- (1) This RTS establishes certain conditions under which some member states can continue applying a waiver on the use of the IRB approach for certain equity exposures. The BSG welcomes the development of regulatory technical standards that contribute to the harmonization of prudential regulation. However, this draft RTS basically proposes maintaining the status quo as at the end of 2007, without more elaborate analysis on whether the above mentioned exceptions (which imply a less demanding treatment) were granted. As such, it does not imply any significant progress towards convergence in prudential rules. A more ambitious approach could be followed instead of simply “grandfathering” this treatment (although admittedly only until the end of 2017). For example, and in the interests of transparency, certain disclosure requirements for the portfolios benefiting from this favourable treatment could be considered.
- (2) In order to smooth the transition from Basel I to Basel II, at a time when it was common practice for banks in some jurisdictions to maintain relevant portfolios of industrial holdings, CRD I included an exemption from the IRB treatment, and the application of the less demanding standard method for equity portfolios, that had to be granted by national competent authorities on a fully discretionary basis. The exercise of this national discretion gave rise to competitive distortions between banks using internal models, as some national competent authorities applied the exemption to institutions under their supervision whilst others did not.
- (3) Maintaining the status quo of those equity portfolios that benefit from lower capital requirements does not imply progress towards the desired harmonisation of capital requirements in the EU. Nevertheless, there are two factors that limit the possible impact of this exemption: (i) the fact that the volume of shares in the portfolios that could benefit from this better treatment have a very restricted ability to increase over time but; on the contrary, they tend to decrease steadily as positions are sold or mature, and (ii) the temporary nature of this exemption, that expires on 31 December 2017. Furthermore, the results of the survey conducted by EBA suggest that the impact of any proposed change would be immaterial in most institutions. Although the conclusion seems warranted for most institutions, according to the figures provided by EBA, it could be more important for some entities, as Figure 1 of the draft shows, where maximum values are material. As disclosed capital ratios are affected

by criteria used for capital requirements, it would be misleading to compare entities applying different criteria.

- (4) Some of the justifications provided in the draft for maintaining the status quo are relevant, such as the fact that it provides continuity with the former legislative framework and that the power to harmonize has limited potential since the empowerment to competent authorities to grant the exemption has already been introduced in the CRR.
- (5) Nevertheless, we consider that as the CRR, differently from CRD I, narrows the freedom of competent authorities and imposes specific conditions to be met, it could be useful to require, as additional criteria to the one considered in the draft, that institutions disclose in their Pillar III information on equity portfolios that are benefiting from this exemption from the IRB treatment provided for in Article 495 of CRR. This would increase transparency (thereby facilitating investors' assessment and comparability of capital ratios) while at the same time preserving the legitimate expectations of the institutions which were, under the former regime, granted the exemption.
- (6) Regarding the suggestion to require disclosure as an additional criterion to the one considered in this submission, BSG member Sandra Hafner (EAPB) holds the opinion that this additional requirement is neither necessary nor warranted. According to Art. 452 part c (v) of EU 575/2013, the treatment of equity exposures in the IRB approach is already subject to disclosure. The mandate given to EBA in Art. 495 para 3 of EU 575/2013 addresses the conditions according to which competent authorities shall afford the exemption and not the obligation for disclosure. In addition, the exercise of the national discretion in Art. 495 para 1 of EU 575/2013 is subject to supervisory disclosure by the competent authority."

### 4.3 Feedback on the public consultation and on the opinion of the BSG

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

The consultation period lasted for 2 months and ended on 7 July 2014. One response was received, which was published on the EBA website.

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

No changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

#### Summary of key issues and the EBA's response

The main point raised by the BSG with regard to the draft RTS is that it could be useful to require, as additional criteria to the one considered in the draft, that institutions disclose in their Pillar III information on equity portfolios that are benefiting from this exemption from the IRB treatment provided for in Article 495 of CRR. According to the BSG opinion, this would increase transparency (thereby facilitating investors' assessment and comparability of capital ratios) while at the same time preserving the legitimate expectations of the institutions which were, under the former regime, granted the exemption.

With respect to it, it should be noted that point (iv) in Article 438 (d) of Regulation (EU) No 575/2013 requires institutions to disclose, among the information regarding their compliance with the requirements laid down in Article 92 CRR, 8% of the risk-weighted exposure amounts of the equity exposures subject to grandfathering provisions regarding own funds requirements. Therefore, institutions are required to publish relevant information on the exposures that benefit from this special treatment as part of their general disclosure requirements on the capital requirements.

**As a result of the analysis of the responses received to this Consultation Paper, the EBA has not made any amendment to the draft RTS on the treatment of equity exposures under the IRB Approach under Article 495(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR).**