

## EBA FINAL draft Regulatory Technical Standards

On the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets under Article 390(8) of Regulation (EU) No 575/2013



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## 1. Executive Summary

The CRR/CRD IV<sup>1</sup> (the so-called Capital Requirements Regulation, (the 'CRR'), and the so-called Capital Requirements Directive (the 'CRD') set out prudential requirements for banks and other financial institutions which will apply from 1 January 2014. The CRR contains specific mandates for the EBA to develop draft Regulatory Technical Standards (the 'RTS'), namely in the area of large exposures.

In particular, Article 390(8) of the CRR mandates the EBA to develop draft RTS specifying the conditions and methodologies used to determine the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets, and also the conditions under which the structure of the transaction does not constitute an additional exposure. The EBA is requested to submit this draft RTS to the European Commission (the 'Commission') by 1 January 2014.

### Main features of the draft RTS

In order to determine the overall exposure to a client or a group of connected clients, in respect of clients to which an institution has exposures through collective investment undertakings ('CIUs'), securitisations, or other transactions where there is an exposure to underlying assets (also referred to as 'transactions with underlying assets' or 'transactions'), Article 390(8) of the CRR requires that an institution assess the underlying exposures taking into account the economic substance of the structure of the transaction and the risks inherent in the structure of the transaction itself.

The *Guidelines on the implementation of the revised large exposures regime* issued by the Committee of European Banking Supervisors in December 2009<sup>2</sup> (the 'CEBS Guidelines') include detailed guidance on the treatment of exposures to schemes with underlying assets and tranching products for large exposures purposes. The EBA has therefore developed the draft RTS using the CEBS Guidelines as a starting point, but it has also considered the experience gathered by national supervisory authorities in the application of these Guidelines and other relevant market developments.

In short, this draft RTS sets out the methodology for the calculation of the exposure value of exposures to transactions with underlying assets, the procedure for determining the contribution of underlying exposures to overall exposures to clients and groups of connected clients, and also the conditions under which the structure of a transaction does not constitute an additional exposure.

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<sup>1</sup> Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 and 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. 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.

<sup>2</sup> The CEBS Guidelines can be found at: <http://www.eba.europa.eu/regulation-and-policy/large-exposures/guidelines-on-the-revised-large-exposures-regime>

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Taking into account the feedback received during the public consultation, the EBA considers it appropriate to permit institutions not to identify the obligors of underlying assets where the exposure value is sufficiently small to only immaterially contribute to the overall exposure to a certain client or group of connected clients. The immateriality condition will be fulfilled in cases where the exposure value of an institution's exposure to each underlying asset is smaller than 0.25% of the institution's eligible capital.

### Particular features of the draft RTS

Article 3 of the draft RTS requires institutions to follow the approaches set out in Articles 5 and 6 for the identification of the overall exposure to a certain client or group of connected clients resulting from a transaction with underlying assets.

Article 4 deals with the case of funds of funds and requires institutions to look through up to the last layer of underlying assets as this is the only way to identify all exposures to all obligors which are relevant for large exposures purposes. This article also requires that the exposure to a transaction be replaced by the exposures underlying this transaction.

Articles 5 and 6 set out the calculation method for the overall exposure to a client or group of connected clients which results from a transaction with underlying assets.

The calculation of the total exposure to a certain obligor that results from exposures to a transaction with underlying assets requires that, as a first step, the exposure value is identified separately for each exposure. In cases where the exposures of other investors rank *pari passu* with an institution's exposure – as in the case of CIUs – the determination of the exposure value of an exposure to an underlying asset reflects the pro rata distribution of losses. In cases where exposures rank differently – as in the case of securitisations – losses are distributed first to a certain tranche and then, where there is more than one investor in this tranche, among the investors on a pro rata basis. In this case, the maximum loss to all investors in a certain tranche is limited by the total exposure value of this tranche and it cannot exceed the exposure value of the exposure formed by the underlying asset. This limitation of maximum loss is reflected by using the lower of the two exposure values and then applying the procedure for recognising the pro rata distribution of losses amongst all exposures that rank *pari passu* in this tranche, where there is more than one investor in this tranche.

As explained above, the EBA considers it appropriate to permit institutions not to identify the obligors of underlying assets where the exposure value is sufficiently small to only immaterially contribute to the overall exposure to a certain client or group of connected clients. The immateriality condition will be fulfilled in instances where the *exposure value of an institution's exposure to each underlying asset is smaller than 0.25% of the institution's eligible capital*. As a result:

- Where the exposure value is smaller than 0.25% of an institution's eligible capital, the institution does not need to apply the look-through approach and can assign exposure to the transaction as a separate client, therefore only limiting its exposure to the transaction itself.
- Where the exposure value is equal to or larger than 0.25% of an institution's eligible capital, the institution needs to apply the look-through approach and identify the obligors of all credit

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risk exposures underlying the transaction. The institution is then required to determine the exposure value and add it to the relevant client or group of connected clients.

If it is not possible or feasible to look-through some (or all) of the underlying assets of a given transaction, the institution needs to assign its exposure to those unidentified underlyings to the 'unknown client'. The large exposures limit applies to the 'unknown client' in the same way that it applies to any other single client. The only exception to this treatment is if the institution can ensure – by means of the transaction's mandate – that there is no possibility that the underlying assets of the transaction are connected with any other direct and indirect exposures in their portfolio (including other transactions). Only in this particular case can material exposures be assigned to the transaction as a separate client.

- Where an institution is not able to distinguish between the underlying assets of a transaction, it cannot be excluded that the total investment creates a single exposure to a certain obligor. Therefore the institution needs to consider the amount of the investment in the transaction as a single exposure (instead of considering its exposure to the individual underlyings) before the application of the materiality threshold.

Article 7 fulfils the second part of the EBA's mandate and sets out the conditions under which a transaction does not constitute an additional exposure. The draft RTS proposes that this be the case when it can be ensured that losses on an exposure to this transaction can only result from events of default for underlying assets, and, therefore no additional exposure exists.

In the development of this draft RTS the EBA has considered the responses to the public consultation on its draft proposals, as well as the opinion of the Banking Stakeholder Group.

This draft RTS will replace Part II '*Treatment of exposures to schemes with underlying assets according to Article 106(3) of Directive 2006/48/EC*' of the CEBS Guidelines.

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## 2. Background and rationale

The so-called Omnibus Directive<sup>3</sup> amended the directives that are collectively known as the CRD<sup>4</sup> in a number of ways, one being to establish areas in which the EBA is mandated to develop draft technical standards.

On 26 June 2013, revised CRD texts were published in the Official Journal of the EU. This aims to apply the internationally agreed standards adopted within the context of the Basel Committee for Banking Supervision (known as the 'Basel III framework') in the EU. These texts have recast the contents of the CRD into a revised directive (the 'CRD') and a new regulation (the 'CRR'), which are together colloquially referred to as the CRR/CRD IV.

Article 390(8) of the CRR requires the EBA to develop draft RTS aimed at specifying the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets and also the conditions under which the structure of the transaction does not constitute an additional exposure. The EBA is requested to submit this draft RTS to the Commission by 1 January 2014.

### Background on this draft RTS

Exposures can arise not only through direct investments, but also through investments in transactions like CIUs or structured finance vehicles (e.g. securitisations), which themselves invest in underlying assets. From a supervisory perspective these investments can be considered in two different ways: on the one hand there may be true diversification benefits, on the other hand the excessive or imprudent use of such investment opportunities may lead to single name credit risk concentration which needs to be limited by the large exposures regime.

This supervisory concern was addressed in the course of the revision of the large exposures regime in the CRD II process. As a general principle, institutions were required to look through to the individual assets and recognise them as clients or groups of connected clients. This is because the large exposures regime aims at capturing and limiting the maximum loss caused by the default of a certain obligor. The objective of the large exposures regime differs from the prudential objective of the capital requirements for credit risk which protect against average losses caused by defaults within a group of obligors having a comparable risk of default. Therefore there is justification for the single name related large exposures regime to not simply adopt the approach taken by the solvency regime but to set out its own solution. In addition, the look-through approach is considered to be the most appropriate approach to detect single name credit risk concentration comprehensively and to prevent institutions circumventing the large exposures limit by concealing exposures to a certain obligor in opaque

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<sup>3</sup> Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authorities: the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

<sup>4</sup> Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions.

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structures. In the event of a default, it does not make any difference whether an institution is exposed to an obligor directly or indirectly via a transaction with underlying assets.

Article 106(3) of Directive 2006/48/EC<sup>5</sup>, as transposed by each Member State, sets out this approach. In order to ensure the harmonised implementation of this provision, the Committee of European Banking Supervisors issued its '*Guidelines on the implementation of the revised large exposures regime*' on 11 December 2009 (the 'CEBS Guidelines').

Article 390(8) of the CRR continues to require an institution, which has exposures through securitisation positions or in the form of units or shares in CIUs or through other transactions with underlying assets, to assess its underlying exposures. The wording of Article 390(8) of the CRR has been modified from that in Article 106(3) of Directive 2006/48/EC in order to provide further clarity. As there are no significant changes in terms of content, the CEBS Guidelines served as a starting point for preparing this draft RTS, although the EBA has also taken into account the experience gathered by the national supervisory authorities in the application of the CEBS Guidelines and other market developments.

One important difference from the CEBS Guidelines is the treatment of securitisation positions. The CEBS Guidelines considered that credit enhancements should be taken into account for large exposure purposes. However, those Guidelines also highlighted two concerns with respect to the treatment of tranching products: (i) it is not easy to reassess the underlying portfolio on a continuous basis, and thus subordinated tranches may have been exhausted without the institution having time to recognise the increase in the exposure to certain names (as well as the decrease in others); and (ii) the risk of sudden breaches of large exposures due to the exhaustion of subordinated tranches, and the need to reduce positions regardless of the market conditions, with the risk of selling at a loss. In order to address these concerns, the EBA considered it necessary to establish a more prudent treatment for securitisations.

In this draft RTS, the EBA has tried to address the shortcomings of the treatment of securitisations as set out in the CEBS Guidelines and proposes that any protection provided by subordinated tranches to other tranches not be recognised. As such, all tranches in a securitisation will be treated equally, as if they were a first loss tranche, fully exposed to the underlying names in the pool. In a worst case scenario, as there is uncertainty on which names will default first, subordinated tranches may be absorbed to cover losses of certain names while leaving others totally uncovered. While the EBA acknowledges that this will happen sequentially, there is no certainty that an institution will be able to reduce any additional exposures to the same obligor as soon as a reassessment reveals that the previously ignored securitisation exposure now unavoidably contributes to the large exposures concerns as defaults in a portfolio arise and as credit enhancement is extinguished.

To sum up, the fact that defaults may happen simultaneously, or in a very short period of time, leading to unintended effects, as already signalled in the CEBS Guidelines (sudden breaches of limits, the need to reduce exposures very quickly), has led the EBA to consider a more conservative and

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<sup>5</sup> Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.

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prudent treatment appropriate. In sum, the EBA considers it more prudent not to recognise the mitigation effect of tranches from inception, assuming that investors in any tranche are fully exposed to any underlying name (although, obviously, in proportion of the amount they hold in a given securitisation tranche). In EBA's view, not recognising the risk mitigation of subordinated tranches is the treatment which is more compatible with the objectives of the large exposures framework as a back-stop regime.

This draft RTS also makes clear that only credit risk exposures need to be considered for large exposures purposes as only the idiosyncratic risk posed by a client is relevant for this purpose, i.e. the overall loss resulting from the default of a client is what the large exposures regime aims to prevent. As a result, underlying exposures where there is no risk of an obligor of the underlying assets defaulting do not need to be considered for large exposures purposes. This applies to funds which have real estate or commodities as underlying assets, which, although exposed to market risk, do not pose a risk of default.

The EBA notes that, according to the provisions of Article 390(6)(e) of the CRR, exposures which are deducted from own funds in accordance with the rules set out in the Draft RTS on own funds - Part Three) should not be considered for large exposures purposes.

The EBA considers that the identification of the obligors of all the underlying exposures of a transaction is the most appropriate approach for determining interconnections between the indirect underlying exposures and an institution's direct exposures to clients or groups of connected clients. As a general rule, institutions which invest in transactions with underlying assets should always identify the obligors of all underlying exposures of their investments, search for interconnections between clients and assign all exposures to one client or a group of connected clients. Adding indirect exposures to the ones that are directly held by an institution, as well as recognising all interconnections, is crucial for compliance with the large exposures limit and for ensuring that the large exposures regime achieves its objectives as a back-stop regime.

However, the EBA recognises that when the underlying exposures are very small (and the transaction itself is below the large exposures limit) the contribution to the total risk of default of the respective obligor does not constitute a very significant concern from a large exposures' perspective. Therefore, if the exposure value is sufficiently immaterial, an institution's exposure to the unknown underlying assets should be assigned to the transaction as a separate client. The EBA considers that, for this purpose, the exposure value of an institution's exposure to each underlying asset should not exceed 0.25% of the institution's eligible capital, which is equivalent to saying that the exposure value should not exceed 1% of the transaction value which is limited to 25% of the institution's eligible capital.

This threshold ensures that at least 100 such exposures would be needed to reach the large exposures limit (25% of the institution's eligible capital) for the overall exposure to a client or group of connected clients. In addition, by designing the threshold on the basis of the eligible capital makes it consistent with the definition of a large exposure and the objectives of the large exposures regime.

In the EBA's view, the introduction of the materiality threshold addresses several of the concerns raised by respondents to the public consultation, namely the call to exempt certain types of exposures

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(e.g. retail exposures), and the need to alleviate the burden of identifying thousands of immaterial exposures

In accordance with Article 395(3) of the CRR, institutions have to comply with the large exposures' limits at all times. The EBA believes that for meeting this requirement, an institution needs to monitor changes in the underlying assets of a transaction on a regular basis. For static portfolios, where the underlying assets do not change over time, regular monitoring will not entail additional work and will have no material additional costs. For dynamic portfolios, the treatment is more complicated as the relative portions of the underlying assets as well as the composition of a transaction itself can change. In these cases, the EBA believes that it would be sufficient if an institution monitored the composition of a transaction at least monthly. The monitoring is particularly relevant for the reassessment of the materiality test.

The review of the large exposures' framework by the Basel Committee of Banking Supervision is still underway.

This draft RTS will replace Part II '*Treatment of exposures to schemes with underlying assets according to Article 106(3) of Directive 2006/48/EC*' of the above-mentioned CEBS Guidelines.

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3. EBA FINAL draft Regulatory Technical Standards on the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets under Article 390(8) of Regulation (EU) No 575/2013

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<sup>6</sup>, and in particular Article 390(8) thereof,

Whereas:

- (1) In order to identify the total exposure to a certain obligor that results from the institution's exposures to a transaction, it is necessary to first identify the exposure value separately for each of these exposures. The total exposure value should then be determined by the aggregate of these exposures, but should not be larger than the exposure value of the exposure formed by the underlying asset itself.
- (2) If exposures of other investors rank pari passu with the institution's exposure, this ensures that losses are always distributed amongst these exposures according to the pro-rata ratio of each of these exposures. Hence, the maximum loss to be suffered by the institution in case of a total loss on an underlying asset is limited to the portion according to the ratio of the institution's exposure to the total of all the exposures that rank pari passu. This pro rata distribution of losses should be reflected when determining the exposure value of an exposure to an underlying asset.
- (3) For some transactions all investors rank pari passu such that their resulting exposure to an underlying asset is solely dependent on the pro-rata ratio of the investor's exposure in relation to the exposures of all investors. While this in particular can occur in respect of collective investment undertakings, other transactions such as securitisations can involve tranching where exposures can rank differently in seniority. Losses are distributed first to a certain tranche and then, in case of more than one investor into this tranche, amongst the investors on a pro rata basis. In this case, and in line with a worst case scenario, where subordinated tranches may disappear very quickly, all tranches in a securitisation should be treated equally. In particular, the maximum loss to be suffered by all investors in a certain tranche in case of a total loss on an underlying asset should be recognised since no mitigation should be recognised from subordinated tranches. This treatment should be subject to two limits: (i) the total exposure value of this tranche (since the loss for an investor in a given tranche that stems from the default of an underlying asset can never be higher than the total exposure value of the tranche) and (ii) the exposure value of the exposure formed by

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<sup>6</sup> OJ L 176, 27.6.2013, p. 1.

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the underlying asset (since the institution can never lose more than the amount of the underlying asset). This limitation of maximum loss should be reflected by using the lower of the two exposure values and then applying the procedure for recognising the pro-rata distribution of losses amongst all exposures that rank *pari passu* in this tranche, in case of more than one investor in this tranche.

- (4) Although it is expected that institutions that invest in transactions should always identify the obligors of all credit risk exposures resulting from underlying assets held through these transactions, there may be cases where this would create unjustifiable costs for the institution or where other circumstances prevent in practice the institution from identifying a certain obligor. As such, where an exposure to an underlying asset is sufficiently small to only immaterially contribute to the overall exposure to a certain client or group of connected clients, it is sufficient to assign this exposure to the transaction as a separate client. The total of such exposures to underlying assets of the same transaction is then still limited by the large exposures limit for this transaction.
- (5) For identifying whether an exposure to an underlying asset does only immaterially contribute to the overall exposure to the respective client or groups of connected clients, the exposure value should be limited to an amount that ensures that at least 100 of such exposures would be needed to reach the large exposures limit for the overall exposure to the client or group of connected clients. With regard to the limit of 25% of the institution's eligible capital, this requires to consider an exposure as immaterial enough for assigning it to the transaction as a separate client instead of the 'unknown client' only if the exposure value does not exceed 0.25% of the institution's eligible capital.
- (6) In order to prevent an unlimited overall exposure resulting from information deficiencies, it is necessary to assign exposures – for which the exposure value exceeds 0.25% of the institution's eligible capital and for which information on the obligor is missing – to a hypothetical client such that the large exposures limit applies to the total exposure to this client. Assigning all such exposures to the same hypothetical client (the 'unknown client') is the most prudent approach.
- (7) Where an institution is not able to distinguish between the underlying assets of a transaction in terms of their amount, it cannot be excluded that the total investment causes a single exposure to a certain obligor. In this case, the institution should assess the materiality of the total value of its exposures to the transaction before being able to assign it to the transaction as a separate group of connected clients instead of the 'unknown client'.
- (8) A transaction cannot constitute an additional exposure where the circumstances of the transaction ensure that losses on an exposure to this transaction can only result from default events for underlying assets. Only two cases should be considered to cause additional exposures. The first is where the transaction involves a payment obligation of a certain person in addition to, or at least in advance of, the cash flows from the underlying assets such that the default of this person would cause losses although no default event has occurred for an underlying asset. The second is where investors could suffer additional losses, although no default event for an underlying asset has occurred, if the circumstances of the transaction enable cash flows to be redirected to a person who is not entitled to receive them.

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- (9) Directive 2009/65/EU of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)<sup>7</sup> ensures for UCITS that cash flows are not redirected to a person who is not entitled under the transaction to receive these cash flows. It can therefore be assumed that this source of an additional exposure does not exist for UCITS, nor for entities that are subject to equivalent requirements pursuant to Union legislative acts or to legislation of a third country.
- (10) The existence and the exposure value of exposures to a client or group of connected clients resulting from exposures to a transaction is not dependent on whether the exposure to the transaction is assigned to the trading book or the non-trading book. Therefore, the conditions and methodologies to be used for identifying resulting exposures to underlying assets should be the same, irrespective of whether the exposure to the transaction is assigned to the trading book or the non-trading book of the institution.
- (11) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) to the Commission.
- (12) The European Supervisory Authority (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>8</sup>.

HAS ADOPTED THIS REGULATION:

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<sup>7</sup> OJ L 302, 17.11.2009, p. 32.

<sup>8</sup> OJ L 331, 15.12.2010, p. 12.

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## *Article 1*

### *Subject matter*

This Regulation specifies:

- a) the conditions and methodologies used to determine the overall exposure of an institution to a client or a group of connected clients in respect of exposures through transactions with underlying assets;
- b) the conditions under which the structure of transactions with underlying assets does not constitute an additional exposure.

## *Article 2*

### *Definitions*

For the purpose of this Regulation the following definitions shall apply:

- a) ‘transactions’ mean, in accordance with Article 390(7) of Regulation (EU) No 575/2013, transactions referred to in points (m) and (o) of Article 112 of that Regulation and other transactions where there is an exposure to underlying assets;
- b) ‘unknown client’ means a single hypothetical client to which the institution shall assign all exposures for which it has not identified the obligor, provided that Article 6(2) (a) and (b) and Article 6(3) (a) of this Regulation are not applicable.

## *Article 3*

### *Identification of exposures resulting from transactions*

1. An institution shall determine the contribution to the overall exposure to a certain client or group of connected clients that results from a certain transaction in accordance with the methodology set out in Articles 4 to 6. For this purpose, the institution shall determine separately for each of the underlying assets its exposure to this underlying asset in accordance with Article 5.
2. An institution shall assess whether a certain transaction constitutes an additional exposure or additional exposures in accordance with Article 7.

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## *Article 4*

### *Underlying exposures to transactions which themselves have underlying assets*

1. When assessing the underlying exposures of a transaction (transaction A) which itself has an underlying exposure to another transaction (transaction B) for the purpose of Articles 5 and 6, an institution shall treat the exposure to transaction B as replaced with the exposures underlying transaction B.
2. The treatment in paragraph 1 shall be applied to successive underlying exposures of transactions until the underlying exposures are not to such a transaction.

## *Article 5*

### *Calculation of the exposure value*

1. The exposure of an institution to an underlying asset of a transaction is the lower of the following:
  - a) the exposure value of the exposure arising from the underlying asset;
  - b) the total exposure value of the institution's exposures to the underlying asset resulting from all exposures of the institution to the transaction.
2. For each exposure of an institution to a transaction, the exposure value of the resulting exposure to an underlying asset shall be determined as follows:
  - a) if the exposures of all investors in this transaction rank *pari passu*, the exposure value of the resulting exposure to an underlying asset is the pro rata ratio for the institution's exposure to the transaction multiplied by the exposure value of the exposure formed by the underlying asset;
  - b) otherwise, the exposure value of the resulting exposure to an underlying asset is the pro rata ratio for the institution's exposure to the transaction multiplied by the lower of:
    - i. the exposure value of the exposure formed by the underlying asset;
    - ii. the total exposure value of the institution's exposure to the transaction together with all other exposures to this transaction that rank *pari passu* with the institution's exposure.
3. The pro rata ratio for an institution's exposure to a transaction is the exposure value of the institution's exposure divided by the total exposure value of the institution's exposure together with all other exposures to this transaction that rank *pari passu* with the institution's exposure.

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## Article 6

### *Procedure for determining the contribution of underlying exposures to overall exposures*

1. For each credit risk exposure for which the obligor is identified, an institution shall include the exposure value of its exposure to the relevant underlying asset when calculating the overall exposure to this obligor as an individual client or to the group of connected clients to which this obligor belongs.
2. If an institution has not identified the obligor of an underlying credit risk exposure, or where an institution is unable to confirm that an underlying exposure is not a credit risk exposure, the institution shall assign this exposure as follows:
  - a) where the exposure value does not exceed 0.25% of the institution's eligible capital, it shall assign this exposure to the transaction as a separate client;
  - b) where the exposure value is equal to or exceeds 0.25% of the institution's eligible capital and the institution can ensure, by means of the transaction's mandate, that the underlying exposures of the transaction are not connected with any other exposures in its portfolio, including underlying exposures from other transactions, it shall assign this exposure to the transaction as a separate client;
  - c) otherwise, it shall assign this exposure to the unknown client.
3. If an institution is not able to distinguish the underlying exposures of a transaction, the institution shall assign the total exposure value of its exposures to the transaction as follows:
  - a) where this total exposure value does not exceed 0.25% of the institution's eligible capital, it shall assign this total exposure value to the transaction as a separate client;
  - b) otherwise, it shall assign this total exposure value to the unknown client.
4. For the purpose of paragraphs 1 and 2, institutions shall regularly, and at least on a monthly basis, monitor such transactions for possible changes in the composition and the relative share of the underlying exposures.

## Article 7

### *Additional exposure constituted by the structure of a transaction*

1. The structure of a transaction does not constitute an additional exposure if the transaction meets both of the following conditions:

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- a) the legal and operational structure of the transaction is designed to prevent the manager of the transaction or a third party from redirecting any cash flows which result from the transaction to persons who are not otherwise entitled under the terms of the transaction to receive these cash flows;
  - b) neither the issuer nor any other person can be required, under the transaction, to make a payment to the institution in addition to, or as an advance payment of, the cash flows from the underlying assets.
2. The condition in paragraph 1(a) shall be considered to be met where the transaction is one of the following:
- a) an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1 of Directive 2009/65/EU;
  - b) an undertaking established in a third country, that carries out activities similar to those carried out by a UCITS and which is subject to supervision pursuant to a Union legislative act or pursuant to legislation of a third country which applies supervisory and regulatory requirements which are at least equivalent to those applied in the Union to UCITS.

#### *Article 8*

#### *Final provisions*

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

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

Done at Brussels,

*For the Commission  
The President*

*[For the Commission  
On behalf of the President*

*[Position]*

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## 4. Accompanying documents

### 4.1 Cost-Benefit Analysis/Impact Assessment

#### The problem

Exposures can arise not only through direct investments, but also through investments in transactions like CIUs or securitisations, which themselves invest in underlying assets. The excessive or imprudent use of such investment opportunities by institutions may lead to single name credit risk concentration which needs to be limited by the large exposures regime.

As a general principle, institutions are required to look through to the individual assets and recognise them as clients or groups of connected clients. This reflects the fact that the look-through approach is considered the most appropriate way to detect single name credit risk concentration and prevent institutions circumventing the large exposures limit by concealing exposures to a certain obligor in opaque structures. There was however a need to operationalise the application of this approach and, as such, the EBA has been mandated to develop the present draft RTS to specify the conditions and methodologies used to determine the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets, and also the conditions under which the structure of a transaction does not constitute an additional exposure.

This impact assessment ('IA') aims at supporting the decisions laid down in the legal text of the draft RTS and describes the rationale that led to these decisions.

#### The objectives

The general policy objective of the large exposures regime, to which the present draft RTS aims to contribute, is to limit the scope for contagion among institutions (i.e. institutions should be less affected by the default of a counterparty) and contribute to strengthening financial stability.

At the level of the draft RTS, the purpose of the impact assessment is to identify the optimal specification for the preferred regulatory option within the legal parameters set out in the Level 1 legislative text.

The IA conducted in relation to the CRR (SEC (2011)949 final) does not focus on the specific provisions relating to the wider large exposures regime (in terms of monitoring and limitation of such exposures). Therefore, for the purposes of the specific IA being conducted in relation to the draft RTS mandated through Article 390(8), this will refer to the broader prudential principles identified in the wider IA of the CRR and, where possible, identifies specific prudential benefits that are generated through the proposed options.

#### Options considered for the baseline scenario

The development of the IA requires the identification of the baseline scenario, which is technically defined as the situation that would transpire if the provisions contained in the draft RTS were not implemented. Therefore, this situation serves as a counterfactual to the proposed interventions and would also stand as the "do nothing option". Likewise, it would be possible to enable a comparative

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assessment of whether the net benefits of further intervention are justified in the light of the drivers underlying the current situation. Two main options were considered as alternatives to establish the baseline scenario in the context of this draft RTS:

A) The baseline scenario could be structured around the current regulatory treatment of exposures to transactions with underlying assets, as provided for in Article 106(3) of the CRD and the CEBS Guidelines in relation to the treatment for large exposure purposes of transactions with exposures to underlying assets – this option would enable a comparative assessment between the impact of the current proposals relating to the treatment of exposures to underlying assets with the previous regime.

- The CEBS guidelines required institutions to check for connections in relation to investments in schemes which themselves invested in underlying assets (on the basis of control and/or economic interconnectedness), in order to determine the existence of groups of connected clients.
- The granularity threshold for determining whether a look-through approach (LTA) would need to be applied was set at 5% (i.e. the ratio between the value of the individual underlying exposure and the overall value of the total scheme).
- In respect of the treatment of “tranchéd” products (e.g. securitisations), credit risk mitigation was recognised in relation to the subordination of tranches within a structure.

B) The baseline scenario could centre on the implementation of the wider CRD/CRR legislative package, including the wider provisions relating to the large exposures regime, but minus the specific provisions relating to the treatment of transactions with exposures to underlying assets – this option would permit an assessment of the incremental impact of the proposals contained in the current draft RTS, against the wider legislative provisions relating to large exposures as contained in the CRR, to be made.

This draft IA uses option A) as the baseline scenario as it can be better observed and assessed.

### Large Exposures rules – main benefits and costs

Given that the IA conducted in respect of the CRR did not specifically focus on the large exposures rules, it is sensible to summarise the high-level costs and benefits of implementing a large exposures regime in order to establish the context for the IA conducted in respect of the draft RTS.

The rationale for rules limiting institutions’ large exposures is constructed around the anticipated micro- and macro-prudential benefits:

- The main micro-prudential benefit of limiting the absolute size of institutions’ exposures to a single counterparty is the consequent reduction in the individual institution’s probability of default in relation to counterparty default.
- The main macro-prudential benefits centre on the improvement in financial stability through the reduced risk of contagion between institutions due to the default of individual counterparties

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These prudential benefits are anticipated alongside the prudential benefits generated through the risk-based capital requirements regime (hence the rationale for a large exposures regime as a non-risk sensitive backstop to the risk-based capital regime). In theory, the incremental prudential benefits generated by a strengthening of the large exposures regime might be captured by a reference to a reduced probability of default on the part of the individual institution and reduced contagion risk between institutions.

The main potential costs arising from strengthening the large exposures regime are expected to be the following:

- Increased administrative costs - for example, generated through a requirement to monitor exposures to underlying assets on a more granular and/or frequent basis.
- Increased funding costs– for example, by limiting the level of exposures that an institution could maintain in relation to single counterparties, might inhibit the level of economies of scale which the institution might secure in relation to its funding needs and therefore increase the cost of capital to an institution.
- Reduced profitability – for example, by limiting an institution’s level of exposure to a single counterparty, this may reduce the opportunity to fully exploit revenue-generating opportunities and therefore reduce the institution’s overall profitability.

### Specific options considered in the draft RTS

This section summarises the main elements within the draft RTS which have been subjected to an IA. The intention is to highlight the principal areas on which the appraisal and assessment of options has been conducted and eventually come up with the preferred option.

#### Article 5 – Calculation of the relevant exposure value and illustrative examples

This section focuses on the method for calculating the value of an exposure that an institution holds in respect to the underlying assets of a transaction (within the scope of the definition of exposure value as stated in the provisions determining the approach to standardised credit risk within the CRR).

To enable the separate identification of the exposure value for each exposure, Article 5(1) of the draft RTS proposes an initial assessment of the exposure value arising from the underlying asset and compares this to the total exposure value of the institution’s exposures to the same underlying asset, in this case resulting from all exposures of the institution to the transaction. The lower value is then adopted as representing the exposure value of the institution to the underlying asset.

Article 5(2) proposes that the calculation of an institution’s total exposure to an obligor be structured around an assessment of whether the exposures of other investors rank *pari passu* with the institution’s exposure, or whether the exposures are ranked differently. In the former situation, losses are distributed pro rata across exposures (as with investments in CIUs); while in the latter case losses are distributed to specific tranches and, in the event that there are multiple investors in the tranche, on a pro rata basis.

In the case of securitisations, the outlined treatment represents the most prudent approach to the losses potentially incurred in respect of any single-name counterparty default associated with the

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underlying assets, given that no credit risk mitigation is recognised in respect of the pro rata distribution of losses across senior and subordinated tranches. For the purposes of option appraisal, two options have been considered in the development of the treatment of securitisation positions for large exposures' purposes:

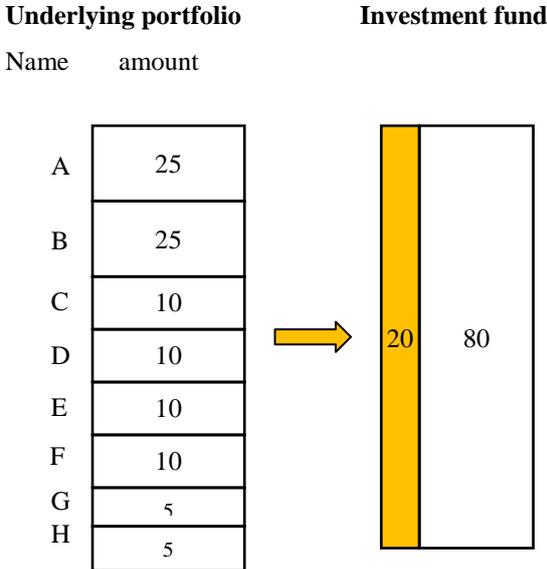
- Option 1: Allowing a certain degree of credit risk mitigation in respect of senior tranches. This option assumes that the calculation of the actual exposure to the underlying names would depend on the seniority of the position held in the securitisation. Therefore the impact of this alternative approach would be to reduce the exposure levels of investors in senior tranches, while potentially increasing exposure levels for investors in junior tranches. In other words, at a micro level, different investors would incur different levels of exposures, while at the macro level the overall level of exposure would not alter in relation to the aggregate of underlying names although the distribution of exposures across investors would change.
- Option 2: Not allowing any degree of credit risk mitigation in respect of senior tranches. This option has been considered as the preferred option as it addresses two supervisory concerns with respect to the treatment of securitisations: (i) it is not easy to reassess an underlying portfolio on a continuous basis, and thus subordinated tranches may have been exhausted without an institution having time to recognise an increase in its exposure to certain names (as well as the decrease in others); and (ii) the risk of sudden breaches of the large exposures' limit due to the exhaustion of subordinated tranches, and the need to reduce positions regardless of the market conditions. In a worst case scenario, as there is uncertainty on which names would default first, subordinated tranches may be absorbed to cover losses of certain names while leaving others totally uncovered. While the EBA acknowledges that this will happen sequentially, there is no certainty that the institution will be able to reduce any additional exposures to the same obligor as soon as a reassessment reveals that the previously ignored securitisation exposure now unavoidably contributes to large exposures concerns, as defaults in the portfolio arise and as the credit enhancement extinguishes. The fact that defaults may happen simultaneously, or in a very short period of time has led the EBA to consider option 2 as the most appropriate from a prudential perspective and also the most compatible with the objectives of the large exposures framework as a back-stop regime.

The following examples illustrate how institutions should calculate relevant exposure value pursuant to Article 5 of the draft RTS.

All examples are based on a transaction with a total volume of 100 and assume that all underlying assets can default in an order which is unknown to the institution. The transaction consists of 8 underlying exposures. In each example, the institution invests an amount of 20 in the transaction.

Example: Article 5 (2) (a) The institution ranks pari passu with other investors

**Example 1:**



The institution invests 20 into the transaction. The pro rata ratio for the institution’s exposure to the transaction according to Article 5(2)(a) in combination with paragraph (3) is 1/5 (20/100).

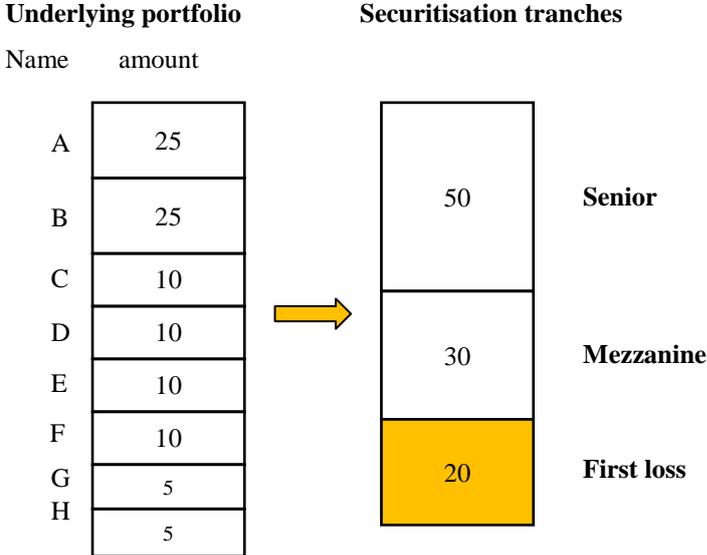
According to Article 5(2) the institution assigns an exposure of:

- 5 to underlyings A and B (1/5x25),
- 2 to underlyings C to F (1/5x10), and
- 1 to underlyings G and H (1/5x5).

In short, in transactions where all investors rank pari passu, the losses are distributed among investors in accordance with the percentage of their participation in the transaction. This proportional loss-sharing affects all names in the underlying portfolio in an equal way and it is not dependent on which name defaults first.

Examples: Article 5 (2) (b) Otherwise

Example 2:

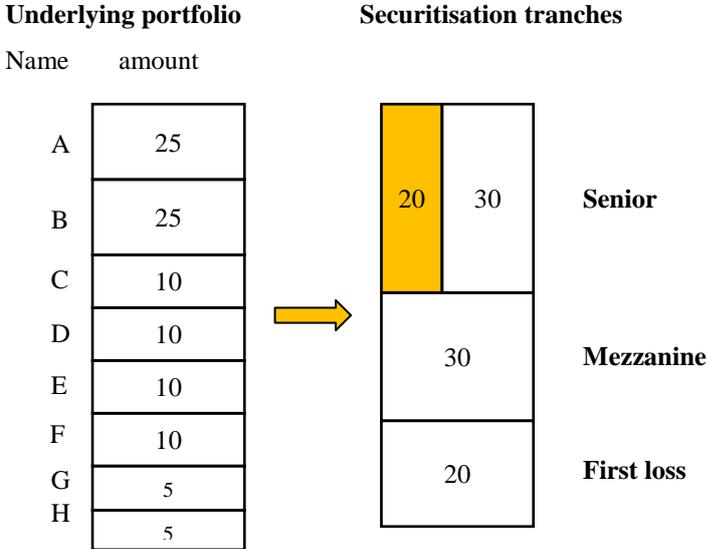


The institution invests 20 in the first loss tranche, i.e. it is the only investor in that tranche. Therefore, the pro rata ratio is 1. Article 5(2)(b) requires that this ratio be multiplied by the lower of the exposure value of the underlying and the value of the first loss tranche.

Therefore, the institution assigns an exposure of:

- 20 to underlyings A and B (1xMin(25;20)),
- 10 to underlyings C to F (1x10), and
- 5 to underlyings G and H (1x5).

Example 3:

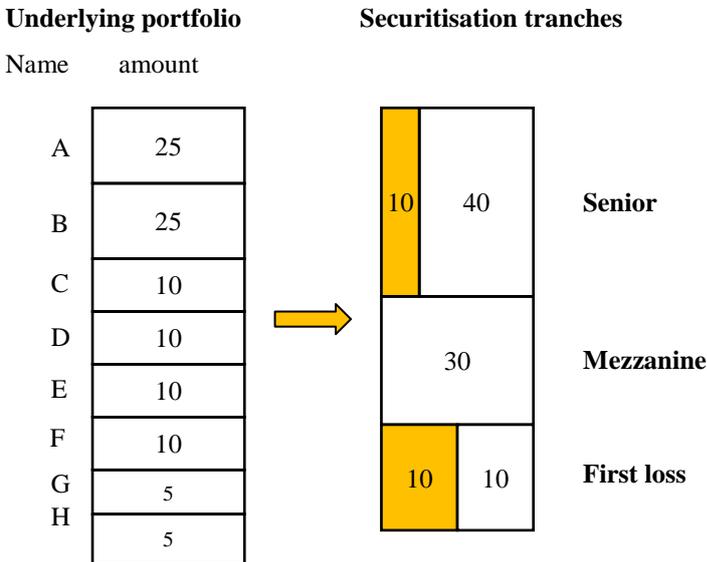


The institution invests 20 in the senior tranche. There are other investors participating in the senior tranche with an investment of 30 ranking pari passu. The pro rata ratio for the institution's exposure to the transaction according to Article 5(2)(b) in combination with paragraph (3) is  $\frac{2}{5}$  ( $\frac{20}{50}$ ). Article 5(2)(b) requires that this ratio be multiplied by the lower of the exposure value of the underlying and the value of the senior tranche, which is in all cases the value of the underlying.

Therefore, the institution assigns an exposure of:

- 10 to underlyings A and B ( $\frac{2}{5} \times 25$ ),
- 4 to underlyings C to F ( $\frac{2}{5} \times 10$ ), and
- 2 to underlyings G and H ( $\frac{2}{5} \times 5$ ).

Example 4:



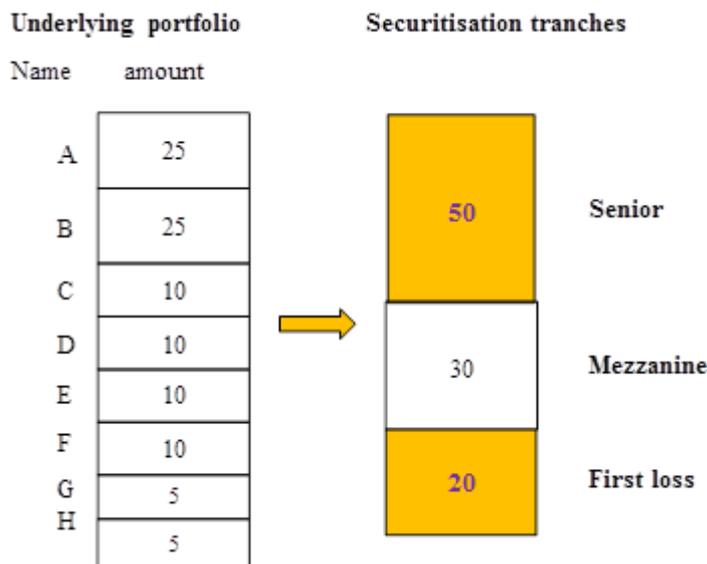
Firstly, the institution invests 10 in the senior tranche. There are other investors participating in the senior tranche with an investment of 40 ranking pari passu. The pro rata ratio for the institution's exposure to the transaction is  $\frac{1}{5}$  ( $\frac{10}{50}$ ). Article 5(2)(b) requires that this ratio be multiplied by the lower of the exposure value of the underlying and the value of the senior tranche, which is in all cases the value of the underlying.

Secondly the institution invests 10 in the first loss piece. The first loss piece amounts to 20. The pro rata ratio here is  $\frac{1}{2}$  ( $\frac{10}{20}$ ). Again, the value of underlyings A and B (25) is higher than the value of the first loss piece (20).

The institution assigns an exposure of:

- 15 to underlyings A and B ( $\frac{1}{5} \times 25 + \frac{1}{2} \times \text{Min}(20; 25)$ ),
- 7 to underlyings C to F ( $\frac{1}{5} \times 10 + \frac{1}{2} \times 10$ ), and
- 3.5 to underlyings G and H ( $\frac{1}{5} \times 5 + \frac{1}{2} \times 5$ ).

### Example 5:



First, the institution invests 50 in the senior tranche. The pro rata ratio for the institution's exposure to the transaction is 1. Article 5(2)(b) requires that this ratio be multiplied by the lower of the exposure value of the underlying and the value of the senior tranche, which is in all cases the value of the underlying.

Second, the institution invests 20 in the first loss piece. The pro rata ratio here is 1. Article 5(2)(b) requires that this ratio be multiplied by the lower of the exposure value of the underlying and the value of the first loss piece.

The institution assigns an exposure of:

25 to underlyings A and B ( $1 \times \text{Min}(25;50) + 1 \times \text{Min}(20;25)$ ) = 45, which in accordance with Article 5(1) is capped by the lower of the exposure value of the underlying and the value of the institution's exposure to the transaction

10 to underlyings C to F ( $1 \times \text{Min}(10;50) + 1 \times \text{Min}(10;20)$ ) = 20, which in accordance with Article 5(1) is capped by the lower of the exposure value of the underlying and the value of the institution's exposure to the transaction

5 to underlyings G and H ( $1 \times \text{Min}(5;50) + 1 \times \text{Min}(5; 20)$ ) = 10, which in accordance with Article 5(1) is capped by the lower of the exposure value of the underlying and the value of the institution's exposure to the transaction

### Article 6 – Procedure for determining the contribution of underlying exposures to overall exposures

Another important issue that has been considered was the potential options for determining whether a threshold should be set, and at which level, in order to establish the treatment of exposures to underlying assets where a specific name cannot be identified (which would therefore be considered under the 'unknown client' bucket).

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- Option 1: No threshold. This was the approach proposed in the consultation paper, which has been rejected following the feedback received during the consultation period. The EBA acknowledges that when the underlying exposures are very small (and the transaction itself is below the large exposures' limit) the contribution to the total risk of default of the respective obligor does not constitute a very significant concern from a large exposures' perspective. The cost of identifying the obligors of those underlying exposures would probably not be justified by its benefits. Therefore, if the exposure value is sufficiently immaterial, the institution's exposure to the unknown underlying assets should be assigned to the transaction as a separate client, which leads to the assessment of option 2 below.
  - Option 2: Introduction of a threshold. The principal benefit of this approach is that this avoids a potentially over-punitive treatment of exposures in respect of the unknown client bucket (which might otherwise incur a formal breach of the large exposure limit irrespective of the level of material risk). The principal cost of this approach is that it might ignore a situation where such small-sized exposures may nevertheless in fact be highly connected or correlated in a default scenario, therefore increasing the level of material risk.
    - Option 2.1: A granularity threshold of 5% of the transaction value. - The EBA has reviewed the option of strengthening the granularity threshold as defined in the CEBS guidelines, which was set at 5% of the transaction value. In terms of principal costs, a lower threshold would presumably incur more administrative effort on the part of institutions to regularly identify and monitor exposures to underlying assets. In terms of principal benefits, a stricter threshold would require that institutions identify the obligors for a higher number of underlying exposures, making sure that the determination of the exposures to clients or groups of connected clients is more accurate, which would contribute to avoid excessive concentration to specific clients or groups of connected clients.
    - Option 2.2: A materiality threshold of 0.25% of an institution's eligible capital. The EBA has considered as the preferred option to apply a threshold which is defined as a ratio between the exposure value of the institution's exposure to each underlying asset and its eligible capital. The design of the threshold on the basis of the eligible capital is preferred given that it is consistent with the definition of a large exposure and the objectives of the large exposures regime. In addition, it does not depend on the size of the transaction, but on the level of the institution's eligible capital which is seen as the most proportional approach. The EBA considers that this materiality threshold should be set at 0.25% of the institution's eligible capital, which ensures that at least 100 of such exposures would be needed to reach the large exposures limit (25% of the institution's eligible capital) for the overall exposure to the client or group of connected clients. In the EBA's view, the introduction of a materiality threshold correctly addresses several of the concerns raised by respondents to the public consultation, namely the call to exempt certain types of exposures (e.g. retail exposures), and the need to alleviate the burden of identifying thousands of potentially immaterial exposures.

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

The BSG provided both general comments and specific responses to the questions presented in the consultation paper as summarised below. The BSG comments have also been included in the feedback table in Section 4.3.

### General comments

#### Credit enhancements

The BSG expressed concern over the non-recognition of credit enhancements in the draft RTS, stating that the basis for this approach contradicted the original intent underlying the large exposures policy regime (i.e. to ensure that losses arising from the sudden default of a single counterparty or group of connected clients could be absorbed without undermining an institution itself). The BSG also states that the approach adopted in the draft RTS contradicts the requirement stipulated in Article 395 of the CRR requiring institutions to monitor the level of credit enhancement which may materially impact the performance of their securitisation positions. The BSG suggests that credit enhancements should be recognised for the measurement of direct exposure to underlying assets.

#### Trading book & banking book

The BSG emphasised that the draft RTS makes no distinction between trading book and banking book positions, which would impact on whether exposures should be reported on a gross or net basis and proposes that liquid trading positions that were shorter in duration than the monitoring frequency should be exempted from the monitoring requirement.

The BSG proposed that on a consolidated level, institutions should be allowed to report against internal limits on maximum potential exposures to connected clients (rather than actual exposures), as this would reflect actual risk management practices employed by institutions and also suggested that the monitoring frequency should accordingly be adjusted to a quarterly basis.

#### Partial look-through approach

The BSG proposed that the approach developed in the draft RTS could be made more flexible by allowing the use of maximum potential exposure (determined by internal limits) rather than using actual exposure values.

#### Treatment of CIUs

The BSG commented that the structure-based approach contained in the CEBS Guidelines should be retained, given that this represents a prudent approach in the case of institutions whose client bases consist of private individuals and SMEs (exposures to which would be rarely incurred as underlying exposures in CIUs). On the issue of a granularity threshold, the BSG objected to the proposed abandonment of a specific threshold and proposed that this should be retained at the level stated in the CEBS Guidelines (5% of scheme value), at least until the Basel Committee of Banking Supervisors' ('BCBS') large exposures regime was finalised. The BSG acknowledged that a granularity threshold could be combined with a materiality threshold, as discussed in the CP, but proposed that this should be set at 1.25% of eligible capital instead of 0.25%. The BSG also proposed that the granularity threshold should be set in terms of proportion of the scheme value, rather than the institution's eligible capital base, as this would reduce monitoring process costs.

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### Structured products

The BSG proposed that the non-recognition of credit risk mitigation impacts from junior tranches could be restricted to the treatment of concentrated structures (i.e. when the number of obligors was below a certain level). Otherwise, institutions should be permitted to recognise a certain percentage of credit risk mitigation impact in relation to investments in senior tranches and a lesser percentage in relation to investments in junior tranches (apart from the first loss piece).

### Grandfathering/transitional period

The BSG proposed that a grandfathering rule similar to that contained in the CEBS Guidelines should be included in the draft RTS, which could differentiate between different types/timing of transactions when specifying the criteria and methods for establishing total exposure.

### Specific responses to consultation questions

**Q1:** The BSG suggested that the examples presented in the consultation paper could be further developed in order to present the calculation method and should be published on the EBA website.

**Q2:** The BSG suggested that in the case of funded credit protection, this should be recognised and treated as cash collateral (thereby reducing the exposure of the underlying names to the amount of collateral received). The BSG commented that the non-recognition of credit enhancement as credit risk mitigation should be reconsidered and proposed that some credit risk mitigation should be recognised in non-concentrated structures.

**Q3:** The BSG commented that more information should be provided on why the draft RTS proposed to deviate from the 5% threshold contained in the CEBS Guidelines and enquired whether there was evidence of regulatory arbitrage taking place in relation to the CEBS Guidelines with regard to the treatment of exposures to single name clients and unknown clients. The BSG commented that the abandonment of a granularity threshold should be reconsidered.

**Q4:** The BSG commented that the alternative proposal presented in the consultation paper for a 0.25% threshold based on eligible capital instead of transaction value should be amended to establish a granularity threshold of 1.25% and that the structure-based approach contained in the CEBS Guidelines should be retained.

**Q5:** The BSG commented that the draft RTS did not distinguish between positions across the trading and banking books and proposed that short-term liquid trading positions should be exempted from the monitoring requirements, while trading book items should be reported on a net basis.

**Q6:** The BSG commented that the listed conditions covered the relevant cases.

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

The EBA publicly consulted on the draft proposal of the draft RTS.

The consultation period lasted for 3 months and ended on 16 of August 2013. 21 responses were received, of which 16 were published on the EBA website. The BSG also provided an opinion on the draft RTS.

This section of the 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.

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

Changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

#### Summary of key issues

##### Granularity threshold

All respondents commented on the absence of a granularity threshold. Although they generally agreed that underlying exposures should be assessed to ensure identification of possible interconnections, they argued that operational difficulties and due diligence burdens needed to be taken into account. Most respondents also strongly criticised the fact that Article 6 no longer provides alternatives to a full look-through, i.e. a partial look-through or a structure-based approach.

The burden of identifying thousands of exposures below the large exposures' threshold is in particular not seen as justified in terms of risk management. Impediments to look-through (banking secrecy laws, granularity and the dynamics of composition, the unavailability of data from issuers, etc.) which lie outside the sphere of the reporting institution would result in most transactions being aggregated and treated as one "unknown client". Without a threshold for look-through, a majority of transactions with thousands of underlying borrowers from different countries or sectors with little likelihood of overlap would have to be treated as one single client, thus severely restricting business. Some respondents suggested allowing multiple "unknown counterparties" where it could be demonstrated that a separated treatment was justified.

The majority of respondents argued that the identification of underlying exposures should only be required for 'material'<sup>9</sup> exposures for the reporting institution in that that they were more likely to result in a build-up of concentration risk and therefore have the potential to cause a breach in any large exposures' threshold as a result of aggregation with direct exposures.

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<sup>9</sup> Though the terms "materiality/granularity threshold" was often used interchangeably, the following distinction was used in the assessment of the feedback: granularity: exposure size in relation to the underlying asset pool; materiality: exposure size in relation to the eligible capital base of the reporting institution.

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Several respondents suggested exempting the following positions from the look-through requirement: i.) retail exposures (e.g. RMBS, student loan, consumer loan, credit card, auto loan); ii.) highly granular portfolios (e.g. CLO, CBMS, CMBX and SME, where the exposure amount should by definition be negligible); and iii) trading book positions.

Some respondents suggested a “sequential approach”, i.e. a combination of a granularity and a materiality threshold (e.g. unknown exposure is below 0.25% of eligible capital and less than 5% of the underlying asset pool), since a mandatory requirement to apply look-through solely based on the criterion of granularity would not accurately reflect the underlying risk, especially if this requirement were to be applied without consideration of the size of the reporting institution. The assessment of whether an investment in a highly granular transaction could possibly constitute a concentration risk can only be done in relation to the capital base of an institution. Moreover, investment in a less granular transaction could only contribute negligibly to concentration risk if the eligible capital were considerably larger.

The majority of respondents remark that the current granularity threshold (5% of transaction volume as set out in the CEBS Guidelines) has proved effective. Only two respondents supported lowering this threshold to 1%. Furthermore, most respondents supported a threshold relating to eligible capital. The numbers suggested vary between 0.25%, 0.5%, 1%, 1.25%, and 2% (without a clear majority in favour of any figure).

Some alternative threshold designs were suggested: e.g. relating the threshold to the number of underlying exposures or the absolute exposure amount; exempting highly granular transactions and requiring look-through only if information is available or the exposure is material; or identifying the general dimensions (asset type, geography) of a pool and adding only the two biggest percentage weights to the unknown client. Some respondents referred to the diversification rules of the transaction: e.g. if a scheme cannot invest more than [10%] of its assets in one single name, the institution should be allowed to take this amount (and not the full investment amount) into consideration for large exposure purposes. One respondent proposed that look-through only be required when the “unknown client” amounts to more than 50% of the large exposure limit.

The EBA has taken the feedback received into account and considered that the introduction of a threshold for the mandatory application of the look-through approach (0.25% of an institutions’ eligible capital) is justified.

#### Treatment of securitisation positions

As regards the treatment of securitisation positions, some respondents criticised on a broader, policy-related level, that treating senior tranches as equivalent to first loss tranches would be inconsistent with all other regulatory approaches and unfairly penalise the senior tranche. By equating all tranches for large exposures’ purposes there might be danger risk of creating a wrong incentive towards investing in junior tranches with higher returns. In addition, the allocation of the same economic risk to multiple single customers would overestimate the actual risk of single counterparty failure. Frequent reference to the CEBS Guidelines, which recognise credit enhancements, was often made. Respondents felt that there was insufficient evidence to support a departure from the CEBS Guidelines and pointed out the positive experiences made in the market since their publication.

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In general, the responses focus on the treatment as set out in the draft RTS and with one exception conclude that the draft RTS is unduly conservative. In addition, respondents present alternative ways, but leave the question of compatibility with the CRR rather unclear.

On a more detailed level, some respondents believed that the EBA assumption of multiple defaults and sudden disappearance of credit enhancement in a very short time frame is at odds with the rationale of the large exposures regime, which aims at preventing existence-threatening losses caused by the sudden default of a single client or a group of connected clients. In relation to the underlying assumption of the large exposures regime, one respondent brings another aspect into play, indicating that the simultaneous default of all underlying names in a securitisation may also be considered as a worst-case scenario.

One respondent proposes recognising credit enhancement by applying the pro rata method to all tranches. Some respondents propose granting a blanket exemption to senior tranche holders. Another respondent requests the same exemption but subjects it to certain conditions: i.) a bank's exposure is to the most senior tranche and in the form of debt, ii.) the securitisation exposure is rated as investment grade or the institution has determined that its exposure is "investment grade". Furthermore, one respondent proposes recognising credit enhancement merely for the N largest underlying exposures; alternatively, recognition of credit enhancement for all underlying exposures on the basis of their share in a portfolio could be considered. Another respondent asks for pro rata recognition of a credit enhancement as a proportion of the subordinated tranches (compared to those in which the bank has positions) in the entire securitisation.

One respondent proposes taking the aspect of concentration into account. The approach set out in the draft RTS should only be applied to concentrated structures, where the number of obligors is below a certain threshold. Above that threshold the institutions would be entitled to reduce the exposure value according to seniority. An investor in a super-senior tranche would be allowed to reduce the exposure value to the highest degree. The first loss position would not profit from an exemption. In non-concentrated structures, the mitigation effect should depend on the share of the largest exposure in the underlying portfolio, the number of tranches and the seniority grade of the tranche.

Some respondents refer to the financial collateral simple method and the financial collateral comprehensive method as CRM techniques eligible under the CRR for large exposure purposes. Without giving a more detailed examination of the relevant articles and conditions laid down by the CRR, the respondents come to the conclusion that when credit enhancement is funded, it can be assimilated to cash collateral and thus reduce the exposure of the underlying names up to the amount of collateral received.

The EBA has considered the feedback received and judged that the arguments presented by the respondents did not justify a change to its initial proposals regarding the treatment of securitisation positions.

#### Monitoring requirement

As regards the monitoring requirement proposed in Article 6(5) of the draft RTS, one respondent questions the legal mandate. The majority of respondents link this question to the absence of the granularity threshold. A monthly monitoring requirement is strongly opposed as long as there is no

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adequately calibrated granularity threshold. Some respondents link the frequency of monitoring with the quarterly reporting requirement. Some respondents point out, that information is often only available on an annual basis. As an alternative to standardising the monitoring frequency, some respondents propose only requiring institutions to use the most recent available information at all times and immediately incorporating any new information into the large exposure analysis. Some respondents suggest that the monitoring frequency could be made dependent on the volatility and composition of a transaction. Some respondents suggest that the proximity to a large exposures breach should be taken into account. They deem monthly monitoring not justified in cases where the largest exposure is considerably lower than 10% of eligible capital. Some argue that such immaterial exposures, as well as trading book exposures (as the holding period is generally shorter than the monthly monitoring requirement), should be exempted from monitoring.

The EBA has taken into consideration the feedback received and has reworded this requirement as an integral part of the methodology for determining overall exposures to clients and groups of connected clients.

#### [Additional conditions for an additional exposure](#)

As regards additional conditions that could be met by a structure to justify that it need not be treated as an additional exposure, several respondents propose that all regulated investment vehicles (authorised by an EU Member State or third country) should be excluded from the provisions of Article 7. One respondent proposes extending the example provided in Article 7(2) to include investments in AIFs as defined under Article 4(1)(a) of the AIFM Directive, No 2011/61/EU (in cases where fund rules do not permit a higher level of leverage than the limit stated in Article 51(3) of the UCITS Directive, No 2009/65/EC), in order to cover undertakings established in the EU with equivalent requirements.

One respondent proposes that the treatment of securitisation or investment fund structures as additional exposures should be modified so that certain contingent payment obligations typical of securitisation transactions would not require such a structure to be treated as an additional exposure, provided that the institution in question treats a portion (corresponding to the bank's proportionate investment in the transaction) of that obligation as an exposure of the bank to the payment provider (e.g. an amount equal to that portion of the facility amount or the exposure value of the derivative contract).

The EBA has considered the feedback received and judged that the arguments presented by the respondents did not justify a change to its initial proposals regarding the conditions for not considering an additional exposure constituted by the structure of a transaction.

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

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<b>General comments</b>			
<b>Interaction of the draft RTS with the CEBS Guidelines and BCBS proposals</b>	Some respondents remark on the timing of the draft RTS, in the context of the BCBS Consultative Document on large exposures and the lack of evaluation of the current rule regime, and on how the draft RTS should be more closely aligned with the 2009 CEBS Guidelines and the BCBS proposals.	<p>The EBA is requested to deliver the draft RTS to the Commission by 1 January 2014.</p> <p>The EBA notes that is not bounded by the CEBS Guidelines in the development of the draft RTS, although the CEBS Guidelines have indeed been the starting point for the development of the draft RTS.</p>	No change
<b>Transitional or grandfathering clauses</b>	Several respondents criticise that the draft RTS does not include transitional or grandfathering arrangements and that the approach provided for through the 2009 CEBS Guidelines should be adopted in the draft RTS (schemes acquired before 31st Jan 2010 treated under previous regime to CEBS GL until 31st Dec 2015). One respondent requests the introduction of a new grandfathering period for schemes acquired before 31st Dec 2013.	The EBA has received no evidence that would justify the grandfathering of existing transactions or the deferred application of certain provisions of the draft RTS.	No change
<b>Definitions</b>	One respondent requests a list of examples to clarify what sorts of transactions, apart from securitisation positions and shares in CIUs, involve underlying assets. One respondent requests that greater clarity be provided on how the terms 'tranches' and 'transactions' are currently used in the draft RTS, plus how the term 'transaction' should refer to the holding of positions in	The EBA notes that the definitions used in the draft RTS are the same as in the CRR.	No change

	underlying assets (rather than movements in terms of buying/ selling the assets in question).		
<b>Guidance</b>	One respondent requests that clearer guidance be provided in respect of the treatment of underlying positions in non-credit exposures (such as real estate and commodities), in order to help determine how these concepts apply in practice. In particular, while direct holdings of underlying non-credit assets are excluded from reporting, it is not clear how this type of investment or exposures should be treated if they are held by a legal person such as a limited company.	The EBA notes that this matter is not part of the mandate for this draft RTS.	No change
<b>Impact Assessment</b>	Two respondents comment that the RTS IA does not consider the potential impact on wider markets or that implementation costs will also fall on customers (who will be required to invest in reporting and data transmission mechanisms to support the primary compliance responsibility placed on institutions). They argue that the draft RTS would result in higher capital requirements for holdings of new credit through securitisations, which would feed through from investing banks to originating banks and then onto non-financial institutions and consumer borrowers, resulting in lower levels of credit creation.	The EBA notes that it has not received data or concrete input regarding the issues mentioned, which could be fed into the impact assessment.	No change
<b>Own Funds RTS</b>	One respondent points out that the interaction between the Large Exposures RTS and the Own Funds RTS (which also seeks to address concentration between financial entities, by specifying the calculation for the deduction of indirect and synthetic holdings of	The draft RTS does not change the basic large exposures rules of the CRR. The exclusion of deducted positions is stipulated in Article 390(6)(e) of the CRR. The interaction with the draft RTS on own funds is clarified in the background section of the draft	No change

	unconsolidated financial sector entities) should be clearly established in order to avoid unintended consequences, particularly as the Own Funds Part III may be subject to significant reworking (therefore impacting on the regulatory capital base used in the Large Exposures limit calculation). It is suggested that the Large Exposures RTS should acknowledge that under CRR Article 390(6), exposures deducted from regulatory capital (including CET1, Additional Tier 1 & Tier 2) should not be included as exposures for large exposures purposes.	RTS.	
<b>Substitution approach</b>	One respondent remarks that securitisation positions should be added to the exposure incurred by liquidity providers (in the case of ABCPs), to avoid creating a divergence between the actual risk assessment conducted by investors and the application of look-through to the underlying assets.	The RTS does not change the basic large exposures rules of the CRR. The consideration of interconnections stemming from funding difficulties is required in Article 4(39) of the CRR. Also relevant is the substitution approach in Article 403 of the CRR.	No change
<b>Pillar 2</b>	One respondent comments that the indirect exposure of institutions to transactions with underlying assets should be addressed through Pillar 2.	The treatment of transactions with underlying exposures is stipulated in Article 390(7) of the CRR. The draft RTS cannot replace it by a Pillar 2 approach.	No change
<b>Responses to questions in Consultation Paper EBA/CP/2013/07</b>			
<b>Question 1.</b> Is the treatment provided in Article 5 sufficiently clear and do the examples	Some respondents feel that the treatment set out in Article 5 is not easy to understand without the examples. They ask that they be developed further after publication of the final RTS and that they be placed on the EBA website under Q&A. Failing that, they ask that a glossary be used to make the text shorter and clearer. Another	The EBA has included the relevant examples in the impact assessment which accompanies the draft RTS to ensure the necessary clarity regarding the application of Article 5 on concrete cases.  The EBA clarifies that the amounts mentioned in the	No change

<p>provided appropriately reflect this treatment?</p>	<p>respondent describes four concrete cases and asks for clarification (bank makes liquidity facilities available, treatment of CLN, treatment of fully supported ABCP program, treatment of collateral provided).</p> <p>One respondent concludes from the examples that according to the RTS, an institution should use the original notional amount as a basis for determining the exposure value in investments in transactions with exposures to underlying assets. The respondent remarks that it appears more appropriate to apply the adjusted notional value for banking book exposures and the market value for trading book exposures.</p>	<p>examples simply mean monetary units and are based on the different exposure measurement methods provided by the CRR. Article 1 of the draft RTS clearly specifies the scope of this draft RTS. It follows from this scope that the question of differently measuring banking or trading book exposures is not touched.</p>	
<p><b>Question 2.</b> Is there an appropriate alternative way of calculating the exposure values in the case of securitisations, which would be compatible with the large exposures risk mitigation framework as set out by the draft CRR?</p>	<p><b>(2.1) From the numerous remarks dealing with the treatment of securitisations as set out in draft RTS the following observations can be highlighted</b></p> <p>On a broader, policy-related level, some respondents criticise in a first step that treating senior tranches as equivalent to first loss tranches would be inconsistent with all other regulatory approaches and unfairly penalise the senior tranche. By equating all tranches for large exposures purposes there might be danger risk of creating a wrong incentive towards investing in junior tranches with higher returns. Secondly, the allocation of the same economic risk to multiple single customers would overestimate the actual risk of single counterparty failure. Finally, a reference to the CEBS Guidelines which recognised credit enhancement is often made. Respondents feel that there is insufficient evidence to</p>	<p>The EBA highlights that the large exposures regime is different from other regulatory approaches, in particular from own funds risk-weighted requirements. Given the different objective of the large exposures regime the EBA believes that a different approach for large exposures purposes is appropriate.</p> <p>The risk-weighted own funds requirements are about the maximum loss an investor could suffer for all underlying exposures in total, weighted by the probability of default events and the probable level of losses in case of a default event. Here it clearly makes sense to differentiate between senior and supporting</p>	<p>No change</p>

	<p>support the departure from the CEBS Guidelines and point out the positive experiences made in the market since their publication.</p>	<p>tranches. However, the large exposures regime has a different objective, focussing on single underlyings and limiting the maximum loss caused by the default of a specific client without any risk weighting.</p> <p>On the continuation of CEBS Guidelines and the indicated positive market experience, the EBA points out that in contrast to the industry feedback, national supervisory authorities do see evidence to support a departure from the CEBS Guidelines.</p>	
	<p>On a more detailed level, some respondents believe that the EBA assumption of multiple defaults and sudden disappearance of credit enhancement in a very short time frame is at odds with the rationale of the large exposures regime, which aims at preventing existence-threatening losses caused by the sudden default of a single client or a group of connected clients. Regarding the underlying assumption of the large exposures regime, one respondent brings another aspect into play, indicating that the simultaneous default of all underlying names in a securitisation may also be considered as a worst-case scenario. Here the losses would be distributed on a pro rata basis to all tranches and in example 3, the exposure to A would amount to 5 instead of 10.</p>	<p>The EBA assumption is not based on a scenario with multiple defaults. The EBA's assumption is that the order of default is unknown. This entails that each of the underlying obligors might be the remaining one after the supporting tranches have been exhausted. As already set out in the background section of this draft RTS, there is uncertainty concerning which names would default first. Subordinated tranches may therefore be absorbed in order to cover the losses of certain names, while leaving others uncovered.</p>	<p>No change</p>

	<p>A large number of respondents refer to Article 395 of the CRR. They confront these due diligence requirements with the statement in the background section of the draft RTS, according to which the EBA believes that there is no certainty that an institution will be able to reassess its large exposures as defaults in a portfolio arise and as credit enhancement is extinguished. Respondents point out that the vast majority of securitisations contain mechanisms for timely adjustment and regular replenishment of credit enhancement, and feel that the EBA's proposal contradicts Article 395 of the CRR.</p>	<p>The notion of the missing ability to “reassess” large exposures was obviously misleading. This was not meant to bring compliance with the due diligence requirements in Article 406 of the CRR into question. On the contrary, the very point is that this reassessment could reveal that previously existing subordinated tranches now have been exhausted and that an institution has become directly exposed to the next default event for one of the obligors of the remaining (i.e. not yet defaulted) securitised exposures. The concern is not that the reassessment would not reveal this situation as soon as it has happened. The concern is rather that this would be too late because the institution would not have been required to take this exposure into account before the subordinated tranches have been exhausted. The institution might therefore have entered additional exposures to the same obligor that has already fully exhausted the large exposures limit. Consequently, what is missing is not the ability to reassess the large exposures but the ability to reduce other exposures to the same obligor in reaction to the outcome of the reassessment.</p>	<p>Amendment to the background section of the draft RTS.</p>
	<p>A large number of responses relate to the specific situation where an institution invests in more than one tranche, as set out in example 4. The proposed treatment is a tranche-by-tranche assessment requiring an investor to add the contributions stemming from both the senior and the first loss tranche. Respondents</p>	<p>The EBA acknowledges that the proposed tranche-by-tranche assessment and the subsequent addition of both amounts, as described in example 4, might lead to conservative results depending on the design of a case. However, the EBA notes that Article 5(1) sets out two limits to this treatment: (i) the total exposure value</p>	<p>No change</p>

	<p>modify the example in such a way that the institution is the only investor in the senior and first loss tranche a (pro rata share of 1). It transpires that by adding the amounts resulting from senior and first loss piece as set out by the explanations to example 4, the institution's exposure to, e.g. "A", equals 45 although the actual exposure amounts to only 25.</p>	<p>of a tranche (since the loss for an investor in a given tranche that stems from the default of an underlying asset can never be higher than the total exposure value of the tranche) and (ii) the exposure value of the exposure formed by the underlying asset (since the institution can never lose more than the amount of the underlying asset). The example provided by the respondent does not in fact consider this cap, which would mean that exposure value would be limited to 25.</p>	
	<p><b>(2.2) Respondents present a wide range of alternative ways of calculating the exposure value in the case of securitisation.</b></p>		
	<p>Two respondents propose simply maintaining the treatment set out in the CEBS Guidelines, as justified by Article 390(7) of the CRR: a reasonable interpretation of the condition mentioned there, "economic substance", would imply recognition of the credit enhancement of junior tranches for senior tranche holders. Under the CEBS Guidelines regime, senior tranche holders could – in the case of a non-granular structure and a corresponding look-through requirement – recognise junior tranches to the full extent for each single underlying name in a securitisation.</p>	<p>As set out in the background section of the draft RTS, the EBA believes for various reasons that the treatment of the CEBS Guidelines is not appropriate. The fact that the term "economic substance" is mentioned in Article 390(7) of the CRR does not lead to a contrary assessment.</p>	<p>No change</p>

	<p>Two other respondents start also from the CEBS Guidelines and propose introducing haircuts for first loss and mezzanine tranches. This would mitigate the risk of a sudden violation of the large exposures limit. The respondents do not specify any details on how to calibrate these haircuts. A haircut of 50% is mentioned by way of an example.</p>	<p>The introduction of haircuts does not address the conceptual concerns the EBA has with recognising supporting tranches as a risk mitigant for large exposures purposes. Besides, a further level of complexity would be introduced and the exact calibration of a haircut seems arbitrary.</p>	<p>No change</p>
	<p>One respondent proposes to recognise credit enhancement by applying the pro rata method for all tranches. In example 3, the institution investing 20 in the senior tranche with 50, and with a total volume of the transaction of 100, would no longer use a pro rata ratio of 20/50, but 20/100.</p>	<p>The EBA does not consider this to be an appropriate treatment. The proposed treatment simply equates securitisations with CIUs and negates the waterfall structure of securitisations.</p>	<p>No change</p>
	<p>Some respondents propose to grant a blanket exemption to senior tranche holders. Another respondent asks for the same exemption, but subjects it to certain conditions: i.) a bank's exposure is to the most senior tranche and in the form of debt, ii.) that securitisation exposure is rated as investment grade or the institution has determined that its exposure is "investment grade".</p>	<p>The idea that more senior tranches are completely risk free has, for good reasons, not been agreed for the risk-weighted capital requirements and in the financial crisis it was empirically shown to be wrong. This idea is therefore even less appropriate, taking into account the objectives of the large exposures regime as a back stop against concentrations in a single client or group of connected clients.</p>	<p>No change</p>
	<p>Furthermore, one respondent proposes to recognise credit enhancement solely for the N largest underlying exposures; alternatively, recognition of credit enhancement for all underlying exposures on the basis of their share in a portfolio could be considered.</p>	<p>A clear rationale for exempting merely the N largest underlyings cannot be identified.</p>	<p>No change</p>

	<p>Another respondent asks for pro rata recognition of the credit enhancement as a proportion of the subordinated tranches (compared to those in which the bank has positions) in the entire securitisation. The respondent argues that this would accommodate EBA's concern that banks might only become aware of the exhaustion of subordinated tranches after a certain delay.</p>	<p>This proposal appears at first sight to simply suggest extending the CRM treatment for direct exposures to securitisation exposures by treating subordinated tranches like credit risk mitigation instruments. The suggested proportional treatment is not what would in fact result from applying CRM rules. Tranches are not linked to a particular securitised exposure, but have to take on losses from any securitised exposure that defaults at just the moment when there is no longer a subordinated tranche available any longer for taking on losses. Consequently, subordinated tranches held by third parties do not provide partial protection to each secured exposure, but give partial protection to the total set of exposures, i.e. they are more comparable to n<sup>th</sup>-to-default portfolio protection instruments.</p> <p>Correctly recognising this partial protection of the securitised portfolio under the CRM rules would therefore require dividing the total exposure value of a portfolio of securitised exposures into portions secured by each of the subordinated tranches and an unsecured portion. An institution's exposure to this unsecured portion is limited to the thickness of the tranche in which the institution is invested and might be additionally limited to a pro rata share of this tranche if other investors have also invested in this tranche.</p> <p>The exposure value that results from correctly</p>	<p>No change</p>
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		<p>considering this situation under the CRM rules is, however, identical to the exposure value resulting from applying the treatment in the draft RTS. Since the order of defaults is unknown, each securitised exposure could default just when the losses exceed the total amount of secured portions of the portfolio and reach into the unsecured portion. Consequently, each of the securitised exposures could, in the event of a default, result in a loss that is completely assigned to the tranche into which the institution is invested. This loss is not assigned on a pro rata basis between the secured and the unsecured portion of a portfolio, unlike for pro rata protection of each underlying exposure as would be the case for CIUs.</p> <p>To give a simple example: if a securitised portfolio consists of three securitised exposures of 10 each and the credit risk is tranching into three tranches of 10 each, the senior tranche of 10 has two subordinated tranches of 10 each. The subordinated tranches do not provide credit risk protection for each of the securitised exposures but only for the 1st and 2nd default respectively. Hence, the securitised exposure defaulting as 3rd is completely unprotected. Since the order of defaults is undetermined, the CRM rules would need to be applied correctly at the level of the whole securitised portfolio. This results in a secured portion of <math>10+10=20</math> for the senior tranche and an unsecured portion of 10 of the total securitised</p>	
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		<p>portfolio. Consequently, the senior tranche could suffer a maximum loss of 10. Assuming that the institution is not the only investor in the senior tranche but has only invested 5, this requires another investor to share the losses assigned to the senior tranche on a pro rata basis, in such a way that the institution can never lose more than 50% of the maximum loss of 10, i.e., never more than 5. This is exactly the same amount that also results from applying the methodology set out in the draft RTS.</p> <p>Thus, if the respondent's proposal correctly considered that tranches held by third parties are solely required to absorb a certain loss amount at portfolio level up to a certain limit, instead of being required to absorb losses on a pro rata basis for each of the securitised exposures, the outcome would be identical to the draft RTS. Therefore, this proposal does not justify a change to the draft RTS. Since, however, the order of defaults is not determined, the maximum loss that an institution could suffer from the unsecured portion of a portfolio needs to be assigned separately to each obligor of one of the securitised exposures.</p>	
	<p>One respondent proposes taking the aspect of concentration into account. The approach set out in the draft RTS should only be applied to concentrated structures, where the number of obligors is below a certain threshold. Above that threshold, institutions would be entitled to reduce exposure value according to</p>	<p>This proposal does not accommodate the EBA's main conceptual concern, which is that the investor in the senior tranche does not know whose default will cause losses absorbed by the senior tranche. For large exposures purposes it is therefore necessary to assume that it could be any of the underlyings,</p>	<p>No change</p>

	<p>seniority. The investor in a super-senior tranche would be allowed to reduce the exposure value to the highest degree. The first loss position would not profit from an exemption. In non-concentrated structures the mitigation effect should depend on the share of the largest exposure in the underlying portfolio, the number of tranches and the seniority grade of the tranche.</p>	<p>specifically to the full extent.</p>	
	<p>Some respondents refer to the financial collateral simple method and the financial collateral comprehensive method as CRM techniques eligible under CRR for large exposure purposes. Without setting out a more detailed examination of the relevant articles and conditions laid down by the CRR, respondents come to the conclusion that when a credit enhancement is funded, it can be assimilated to cash collateral and thus reduce the exposure of the underlying names up to the amount of collateral received.</p>	<p>If the respondent's proposal was correct in considering that credit enhancements are merely required to absorb a certain amount of loss at portfolio level up to an established limit, instead of being required to absorb losses on a pro rata basis for each of the securitised exposures, the outcome would be identical to the draft RTS. Therefore, this proposal does not justify a change to the draft RTS.</p> <p>Correctly recognising the partial protection of a securitised portfolio by credit enhancements under the CRM rules would require dividing the total exposure value of a portfolio of securitised exposures into portions secured by each of the funded credit enhancements and an unsecured portion. An institution's exposure to this unsecured portion is limited to the thickness of the tranche in which the institution is invested and might be additionally limited to a pro rata share of this tranche if other investors have also invested into this tranche. Since, however, the order of defaults is undetermined, the maximum loss that the institution could suffer from the unsecured</p>	<p>No change</p>

		<p>portion of the portfolio needs to be assigned separately to each obligor of one of the securitised exposures.</p> <p>For more details and an example see the response above.</p>	
	<p>One respondent proposes a formula for assessing the credit risk mitigation effect of the junior tranches:</p> $CRM = (1 - r) * (1 - 1/n) * (1 - ((tn-1)/(n-1))^2)$ , where $r$ is the share of the largest underlying exposure in the structure or tranche $n$ is the number of tranches $tn$ is the seniority grade of the tranche with value of 1 for the super senior tranche and a value of 0 for the first loss position <p>In other words, the credit risk mitigation effect would depend on the share of the largest exposure in the underlying portfolio, the number of tranches and the seniority grade of the tranche. The proposed metric is the pro rata share of the institution in the tranche, multiplied by the amount of the tranche and multiplied by (1-CRM).</p>	<p>If the respondent's proposal was correct in considering that junior tranches are solely required to absorb a certain amount of loss at portfolio level up to an established limit, instead of being required to absorb losses on a pro rata basis for each of the securitised exposures, the outcome would be identical to the draft RTS. Therefore, this proposal does not justify a change to the draft RTS.</p> <p>Correctly recognising the partial protection of the securitised portfolio by junior tranches under the CRM rules would require dividing the total exposure value of the portfolio of securitised exposures into portions secured by each of the funded credit enhancements and an unsecured portion. An institution's exposure to this unsecured portion is limited to the thickness of the tranche in which the institution is invested and might be additionally limited to a pro rata share of this tranche if other investors have also invested into this tranche. Since, however, the order of defaults is undetermined, the maximum loss that the institution could suffer from the unsecured portion of the portfolio needs to be assigned separately to each obligor of one of the securitised exposures.</p>	<p>No change</p>

		For more details and an example see response above.	
<p><b>Question 3.</b> Would the application of requirements provided by Article 6(3) and (4) imply unjustified costs to the institutions? Would the introduction of a materiality threshold be justified on the basis of a cost-benefit analysis? Please provide any evidence to support your response.</p>	<p><b>(3.1) Feedback on the full look-through requirement without exemption (“unknown client”)</b> All respondents comment on the removal of the granularity threshold. Though underlying exposures should be assessed to ensure the identification of possible interconnections, they argue that operational difficulties and due diligence burdens need to be taken into account. The following impediments to a full look-through that would result in the vast majority being allocated to the “unknown client” (resulting in forced ad hoc sales of highly fungible investments which serve risk diversification and contribute to profitability) are given:</p> <ul style="list-style-type: none"> <li>• the burden of identifying thousands of exposures that are clearly below the large exposures definition of 10% of own funds (e.g. multi-seller conduits) is not justified in terms of risk management (see figures below) as they would not contribute to an institution’s exposure to a (group of) client(s);</li> <li>• positions held in the trading book are often highly dynamic;</li> <li>• often a look-through is not possible (thousands of underlying exposures, banking secrecy laws, the final borrower is not disclosed by</li> </ul>	<p>As indicated in the background section of the consultation paper, the EBA considered several alternatives for setting out a threshold. However, since more information was needed to calibrate such a threshold appropriately, the EBA wished to obtain feedback from stakeholders on the need for such a threshold from a cost-benefit point of view, and also feedback on its design and level.</p> <p>The EBA has considered the feedback received and finds that it would be justified in introducing a threshold that would mitigate the burden of identifying a very high number of immaterial underlying names for certain transactions. While the general applicable rule should be the look-through approach, it is sensible to avoid unnecessary burdens whenever an investment in these structures is deemed immaterial for large exposures purposes.</p> <p>Since the relevant variable under a large exposures regime is the size of the single name exposure measured in terms of an institution’s eligible capital, the EBA has considered it appropriate to introduce a materiality threshold designed in terms of the</p>	<p>Recitals 4, 5, 6 and 7 and Article 6 (2) and (3) of the draft RTS</p>

	<p>originators/sponsors, dynamic composition) – e.g., underlying retail exposures (RMBS, student/consumer/car purchase loans, credit cards), highly granular portfolios (SMEs); the maximum borrower concentrations are regularly below 1% of the total portfolio size;</p> <ul style="list-style-type: none"> <li>• third party schemes are especially cost-intensive to constantly monitor (particularly when the underlying exposures are known to be immaterial),</li> <li>• the quality and frequency of market disclosure varies. Often, real time access to underlying scheme details is not available or available only at a later point in time (e.g., the annual reports of funds) – this is especially the case for funds of funds. A market standard would need time to establish itself. The timeframe for implementation does not allow for such a complex change involving third-party client systems and processes.</li> <li>• one respondent remarked that detailed disclosure of individual positions to only one investor would constitute a breach of the equal treatment requirement of the UCITS and AIFD directives.</li> <li>• To treat borrowers that are not identified (mainly for personal privacy reasons) as one single obligor, i.e., as if they were connected, even if each securitisation were based on many thousands of individual borrowers from different countries or sectors with thus little likelihood of overlap is not justified. In effect, this would be a regulatory</li> </ul>	<p>institution’s eligible capital.</p> <p>The EBA considers that this materiality threshold should be set at 0.25% of an institution’s eligible capital, which ensures that at least 100 of such exposures would be needed to reach the large exposures limit (25% of the institution’s eligible capital) for the overall exposure to a client or group of connected clients. In practice, only those underlying exposures whose exposure value is higher than 0.25% of an institution’s eligible capital will have to be identified (i.e. application of the look through approach) or, otherwise assigned to the ‘unknown client’.</p> <p>Furthermore, the partial look-through is allowed, which implies that any exposure under the threshold would be exempted from the application of a look-through approach, regardless of whether other exposures were above the threshold.</p> <p>The materiality threshold indirectly addresses the granularity concerns expressed by respondents. Transactions with hundreds or thousands of underlying exposures would be exempted from the application of the look-through approach because their exposure values are negligible (&lt;0.25% of an institutions’ eligible capital). This is particularly the case for retail securitisations (MBS, student loans, consumer loans, credit cards, car purchase loans), retail funds and</p>	
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	<p>construct with the main purpose of restricting market engagement in collective or structured vehicles.</p> <p>One respondent points out that the envisaged lowering of Large Exposures limits by the BCBS and the reduction of the own funds base stemming from changes in the Basel III definition reinforce the constraining effect of the “unknown client” as a fall-back to full look-through.</p> <p><b>The following figures were provided to substantiate the arguments</b></p> <p>One respondent calculated that costs of full look-through of his scheme portfolio would require costs of 3 500 man-hours each reporting cycle merely to capture all underlying exposures to schemes, as for approximately 65% of the total scheme exposure (7 000 schemes) little or no underlying information was available. These costs would increase substantially where the information needs to be sourced or validated.</p> <p>One respondent conducted a survey among 1600 funds with assets totalling EUR 285 bn applying the current CEBS GL regime. 65% of the funds were found to be fully transparent and 17% granular. In 18% of cases assets were considered as one unknown client. Another of its surveys shows that the managers of bank-held CIUs require information from about 530 external investment management companies of target funds. Investment management companies would need huge</p>	<p>other highly granular portfolios.</p> <p>In the remaining cases, the full composition will not have to be available, but only those exposures deemed material for large exposures purposes. As a consequence of the application of the threshold, whenever the investment of an institution in a particular transaction is immaterial (i.e. below the materiality threshold), no identification of the names will be required.</p> <p>Regarding the specific comment on opaque structures, the EBA notes that it is precisely opaque structures that will not consolidate, and this is why a conservative treatment must be established for unidentified names. An institution will consolidate structures for which it substantially retains risks and rewards or exercises control. This will be the case for non-opaque structures (usually originated securitisations). Similarly, an institution investing in multiple transactions with the same obligor would have to connect such exposures only if it identified them. This is why institutions still have an incentive to concentrate them in opaque structures.</p>	
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	<p>IT capacities to make the full current composition of the funds available to the institutions.</p> <p>One respondent remarked that it would have to collect the data of more than 100 million names.</p> <p>Two respondents remarked that circumvention of large exposures limits by concealing exposures in opaque structures seems to be a non-issue, as for accounting reasons, the scheme would have to be consolidated and a look-through would thus be performed mechanically. In addition, an institution investing in multiple schemes with the same obligor would in any case have to connect such exposures to comply with large exposures limits.</p>		
	<p><b>(3.2) The following solutions were offered</b></p> <p>Most respondents support the (re)introduction of a granularity/materiality threshold.</p> <p>The majority of respondents argue that a look-through – i.e. the identification of the underlying exposures – should only be required for exposures ““material”” for the reporting institution in that that they are more likely to result in a build-up of concentration risk and therefore have the potential to cause a breach in any large exposures threshold as a result of aggregation with direct exposures.</p>	<p>As explained above, the EBA has introduced a materiality threshold.</p>	<p>Recitals 4, 5, 6 and 7 and Article 6(2) and (3) of the draft RTS</p>

	<p>Several respondents suggest not applying the look-through requirement to schemes where the underlying assets are:</p> <ul style="list-style-type: none"> <li>→ a retail class: RMBS, student loans, consumer loans, credit cards, car purchase loans;</li> <li>→ a highly granular portfolio: in particular CLO, CBMS (average loan in 2011: 1.9%, in 2012: 1.6%), CMBX and SMEs, where the exposure amount should by definition be negligible.</li> <li>→ trading book positions</li> </ul>	<p>As explained above, the materiality threshold will address the concerns raised reading granular portfolios.</p>	<p>No change</p>
	<p>Some respondents suggest a sequential approach (a combination of granularity and materiality thresholds). It is argued that any assessment of “materiality” (in relation to an institution’s eligible capital) should also be applied in conjunction with some form of assessment of the “granularity” (in relation to the portfolio) of the scheme. A mandatory requirement to apply look-through based on the single criterion of granularity would not accurately reflect the underlying risk, especially if this requirement were applied without consideration of the size of the reporting institution. A combination of thresholds would ensure that sizable exposures which present a higher risk of concentration build-up would always require an assessment of the underlying to determine whether there is any connection to the directly held portfolio (regardless of the granularity of the transaction). It is argued that institutions could have exposures to RMBS</p>	<p>The EBA initially considered the option of combining a materiality and a granularity threshold but finally rejected it. Once an underlying exposure is considered material for large exposures purposes, it is irrelevant whether this exposure is in a fund with 10, 100 or 1000 names. As the large exposures framework aims at preventing sudden losses from the default of a single client, diversification does not play any role.</p> <p>Similarly, if an exposure can be considered immaterial for large exposures purposes, it is not reasonable to require the institution to identify it, no matter whether this exposure belongs to a pool of 10 or 100 names.</p>	<p>No change</p>

	<p>structures whose largest underlying exceeds 0.25% of their eligible capital while transparency remains inappropriate.</p> <p>The following criteria are suggested to ensure that for all material exposures, an institution is required to actively assess the exposure for “hidden” concentration risk:</p> <ul style="list-style-type: none"> <li>➔ Granularity: 5% of total scheme</li> <li>➔ Materiality: 2% of eligible capital</li> <li>➔ In addition: mandatory look-through to each scheme/participation in scheme that is greater than 1% of the institution’s own funds requirements (regardless of granularity)</li> </ul>		
	<p>One respondent argued that securitisations and pools where full principal is guaranteed by a government agency should be exempted from the outset.</p>	<p>The CRR allows the application of the substitution approach (cf. Article 403 of the CRR) and, accordingly, if securitisation positions are guaranteed by a government, they would be exempted from the outset by Article 400(1) of the CRR.</p>	<p>No change</p>
	<p>Some respondents suggest allowing <b>multiple “unknown counterparties”</b> where it can be demonstrated that separate treatment is justified. A break-down could be based on exposure classes or other risk features consistent with internal risk management. This would ensure that the combination of individual sub-categories would not add up to a material “single risk” that could jeopardise a bank’s going concern.</p>	<p>The “unknown client” approach establishes a conservative treatment for the names that an institution does not identify and therefore provides incentives for this identification. The EBA acknowledges that the identification of certain names might be unjustifiably burdensome and addresses this concern by introducing the materiality threshold. For the remaining cases, the EBA deems it appropriate to retain a more conservative treatment and only allow the recognition of a separate client when an objective requirement is met: the mandate ensures that the underlying exposures are not connected to any other exposures</p>	<p>No change</p>

		<p>of the institution. See answer to Q3.3 below.</p> <p>In all other cases, exposures must be aggregated to a single “unknown client” set.</p>	
	<p><b>(3.3) Alternatives to look-through</b>  Most respondents strongly criticise that Article 6 no longer provides alternatives to a full look-through, i.e. a <b>partial look-through</b> or a <b>structure-based approach</b>. Regarding the partial look-through, it is stressed that only the underlying, unidentified exposures should be treated as an “unknown client” (or according to the granularity approach). The identified ones, i.e. the part for which a look-through is affected, should not be treated as an “unknown client” (otherwise the partial look-through is deemed useless).</p>	<p>In addition to the introduction of the materiality threshold, the EBA agrees with the recognition of the partial look-through (see response to Q3.1 above) as well as the structure-based approach as detailed below.</p> <p>The EBA acknowledges that in very particular and limited situations, an institution might be able to prove objectively that there is no possibility that its underlying exposures are related to other exposures in its portfolio. In that case, the EBA considers it appropriate that the exposures be assigned to a separate client instead of the unknown client. At the moment EBA only envisages the case of the mandate of a fund restricting its investments to certain geographical areas or sectors to which the institution has no other exposures.</p>	<p>Article 6 (2) and (3) of the draft RTS</p>
<p><b>Question 4.</b>  Keeping in mind that such a materiality</p>	<p><b>(4.1) Support of the granularity threshold (criterion in relation to transaction volume)</b>  Based on the reasoning above on look-through impediments (see question 3), all respondents support</p>		

<p>threshold would need to be sufficiently low in order to justify that all unknown underlying assets of a single transaction would be assigned to this transaction as a separate client, what would be the right calibration? Would the reference value (an institution's eligible capital) be appropriate for this purpose? Please provide any evidence to support your response.</p>	<p>the (re)introduction of the granularity threshold (though sometimes the terms “granularity” and “materiality” threshold are used interchangeably).</p>		
	<p>The majority of respondents remark that the <b>current granularity threshold</b> (5% of transaction volume) has proved effective. Two respondents support the Basel Committee's suggestion of a granularity test, i.e. the largest underlying exposure should not exceed 1% of the total value of the transaction. Two respondents explicitly oppose the BCBS reduction to 1%, as this threshold would already be met by the cash position held by the funds and as borrower concentrations usually range between 1 and 5%.</p>	<p>The EBA considers that the 5% granularity threshold was not effective all cases. Exposures to funds with a small number of names can still be very relevant in terms of own funds and should not be disregarded for large exposures purposes. Institutions could circumvent large exposures limits by investing in several pools as soon as the names are less than 5% of a total transaction. All these concerns are not relevant in the case of a materiality threshold, defined in terms of an institution's eligible capital.</p> <p>The fact that cash positions may exceed 1% of the total value of a transaction (and might even reach 0.25%) is addressed via the partial-look through. With the current treatment, the largest underlying exposure will not determine the treatment of the remaining exposures. If only cash positions in investment funds are considered material, only these particular positions will have to be identified. As they come from the fund manager itself, its identification should not constitute an additional burden.</p>	No change
	<p>Different approaches to granularity taken by the EBA and BCBS contradict the idea of an international level playing field and give US-regulated investors/sponsors a competitive advantage.</p>	<p>The EBA notes that the review of the large exposures framework being conducted by the BCBS is still underway.</p>	No change

	<p><b>(4.2) Support of the materiality threshold (criterion in relation to eligible capital of reporting institution)</b></p> <p>Some respondents support a threshold relating to eligible capital without providing a possible calibration.</p> <ul style="list-style-type: none"> <li>• Two respondents support a threshold of 0.25% of eligible capital as this would mean that an institution would have to hold 100 of such exposures to the same customer (which is deemed unlikely to occur). One respondent considers a threshold of 0.25% as too strict and resulting de facto in a full look-through requirement.</li> <li>• One respondent supports a threshold of 0.5% of eligible capital.</li> <li>• Three respondents support a threshold of 1% of eligible capital. According to the analysis of one respondent, such a threshold would mean that 20 to 25% of the analysed funds would no longer be considered granular. Furthermore, it was pointed out that given the differences in the own funds base, investment fund companies would anyway have to ensure information for a complete look-through with the result that designing granular funds would become virtually impossible.</li> <li>• Four respondents support a threshold of 1.25% as this would be mostly in line with the current 5% requirement of the CEBS GL. One respondent remarks that in the case of funds of funds or funds with securitisation positions as underlying assets, this threshold of 1.25% should only be applied to</li> </ul>	<p>These comments have been already addressed in the answers above, in particular Q3.1.</p>	<p>Recitals 4, 5, 6 and 7 and Article 6(2) and (3) of the draft RTS</p>
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	<p>each target fund in which a CIU is invested (i.e. no look-through to the underlying assets of the target fund) to avoid a situation where institutions are required to continually apply look-through.</p> <p>Two respondents support a threshold of 2% of eligible capital.</p>		
	<ul style="list-style-type: none"> <li>One respondent opposed introducing a materiality threshold in relation to eligible capital as this would disturb the level playing field, i.e. lead to a different treatment of the same transaction by different (large) institutions or throughout a group of institutions (i.e. solo vs. consolidated level). Furthermore, the respondent argues that lowering the granularity threshold would mean a lot of additional effort and costs compared to the collection of the information for the 5% threshold.</li> </ul>	In the EBA's view, the argument raised on the ““level playing field”” is not a valid one. Concentration risk is always measured for the individual institution and not comparable across different (sizes of) institutions.	No change
	<p><b>(4.3) Suggestions for an alternative threshold design</b></p> <p>One respondent proposes that for securitisation positions, the granularity threshold be fixed to the number of underlying obligors and the single name maximum exposure: transactions with less than 100 obligors and a maximum single obligor exposure below EUR 500 000 should be treated as sufficiently granular (no look-through). For investments in UCITS, a threshold of EUR 100 000 for the largest underlying exposure is suggested.</p>	As mentioned above, a granularity threshold was not deemed adequate. Absolute thresholds (in terms of €) are also not considered adequate as the large exposures regime aims to limit the relative impact on the own funds of an institution.	No change
	<p>One respondent suggests introducing three categories:</p> <p>i) highly granular transactions (like retail asset backed securities) should be exempted from look-through; ii) a</p>	The EBA notes that these comments have been already partially addressed in the answers above.	Recitals 4, 5, 6 and 7 and Article 6(2) and (3) of the

	feasibility test: look-through where access to information is available; iii) a materiality threshold.		draft RTS
	One respondent suggests exempting exposures representing less than 0.25% of the institution's CET1 from look-through and where an exposure represents less than 5% of the underlying asset pool.	The EBA notes that these comments have already been partially addressed in the answers above.	Recitals 4, 5, 6 and 7 and Article 6(2) and (3) of the draft RTS
	One respondent asks the EBA to consider specific granularity thresholds for mutual funds that are subject to clearing requirements under EMIR, which therefore tend to have higher exposure concentrations with respect to its clearing members.	The EBA notes that application of the partial look-through will imply that only these high concentrations with respect to clearing members would have to be identified.	No change
	Some respondents refer to diversification rules of schemes, e.g. a scheme cannot invest more than [10%] of its assets in one single name. In case the underlying names are not known it is suggested that the institution does not have to recognize the full amount invested in the transaction, but only the maximum amount the scheme can invest in a single name [10%*amount invested by institution]. This would reflect the real maximum possible risk in terms of large exposures.	This proposal is too complex for implementation under the large exposures regime. The concern expressed is partially addressed by the fact that if [10%] of a transaction is less than 0.25% of an institutions' eligible capital, then no identification will be required.	No change
	One respondent suggests that for portfolios where the largest unknown obligor is larger than 1% of the portfolio value, the issuer should have two options: i) improve reporting and provide loan level data to allow investors a full look-through; or ii) if providing such detailed information is not possible, the issuer should certify that each obligor is unique. With this confirmation, bank	This proposal is not feasible in practical terms. In the EBA's view, requiring certification that each obligor is unique can be more burdensome than the identification.	No change

	<p>investors can add the largest exposure in the pool to their “unknown” client exposure (i.e. the conservative assumption is that the largest unknown borrower in similar pools is the same, which is more realistic than assuming that all unknown exposures in all pools are to the same obligor).</p>		
	<p>One respondent suggests that banks should be allowed to demonstrate the composition of their securitisation portfolios along two high level dimensions: i) underlying asset type (corporates, SMEs, retail), and ii) geography (Europe, America, Asia). If a bank is capable of deconstructing its securitisation portfolio along these two dimensions, the regulation could state that, e.g., the sum of the two largest percentage weights should be added to the single, unknown client instead of 100% (potentially with conservative add-on for any possible miscalculation). This method would be in accordance with the Large Exposures objectives while easing the information requirements for banks (only two high-level dimensions must be known).</p>	<p>This proposal is too complex for implementation under the large exposures regime. For reasons mentioned above, the unknown client will not be segmented. In any case, these concerns should be alleviated to a great extent with the introduction of the materiality threshold (i.e. most transactions, which are highly granular and with immaterial names, will be exempted from a look-through).</p>	<p>No change</p>
	<p>One respondent suggests an alternative treatment analogous to the granularity treatment for trading book transactions and, furthermore, suggests using the size of the “unknown client” as a criterion for further look-through – i.e. apply look-through if utilisation of the “unknown client” already amounts to more than 50%.</p>	<p>The EBA notes that no different treatment is envisaged for the trading book versus the banking book as it is not justified from a large exposures point of view.</p>	<p>No change</p>
	<p><b>(4.4) Support for a structure-based approach</b> Some respondents explicitly support the (re)introduction of the structure based approach. It is argued that the</p>	<p>The EBA notes that these comments have been already addressed in the answers above.</p>	<p>Article 6 (2)</p>

	<p>materiality of an underlying exposure in respect of the portfolio of a reporting institution depends also on the structure of a transaction. If the investment mandate can ensure that the underlying exposures are not connected to any other direct or indirect exposure in an institution's direct portfolio that is higher than 2% of eligible capital, the exposures could be considered sufficiently immaterial to assign them to the transaction as a separate client instead of the "unknown client".</p>		
<p><b>Question 5.</b> Would the requirement to monitor the composition of a transaction at least monthly, as provided by Article 6(5), imply unjustified costs to the institutions? Please provide any evidence to support your response.</p>	<p><b>(5.1) Legal mandate</b> One respondent remarked that Article 390(8) CRR gives the EBA no legal mandate for establishing a monitoring requirement.</p>	<p>The EBA considers a monitoring requirement to be covered by the legal mandate in Article 390(8) of the CRR, as monitoring is an integral part of the methodology of the assessment of the underlying exposures.</p>	<p>Article 6(4) of the draft RTS</p>
	<p><b>(5.2) Objection to monthly reporting without a granularity/materiality threshold</b> The majority of respondents emphasize that without a granularity/materiality threshold, monthly monitoring would require institutions to analyse thousands of underlying exposures for highly granular transactions or exposures of immaterial size (information from various sources, received in various formats, and from multiple companies would have to be assessed). This would imply prohibitively high administrative costs (potentially preventing institutions from further funding such transactions) without positive impact on the measurement of idiosyncratic risk.</p>	<p>As noted in the responses above, a materiality threshold has been introduced.</p>	<p>Recitals 4, 5, 6 and 7 and Article 6(2) and (3) of the draft RTS</p>

	<p><b>(5.3) Monitoring frequency</b></p> <p>a) <u>Monthly</u>: One respondent supports monthly monitoring, as such a frequency is already in place and is also deemed a reasonable approach from a cost/benefit perspective. Another respondent supports monthly reporting given a reasonably calibrated materiality threshold (WKO).</p> <p>b) <u>Quarterly</u>: Some respondents point out that monthly monitoring would not be in line with the quarterly reporting frequency generally foreseen in the EBA reporting ITS. Moreover, market information is often only available on a quarterly basis (e.g., the covered bond market) (WKO, Barclays, RBS, JPM). Thus, a quarterly monitoring requirement is seen as preferable (WKO, Dt. Bank, JPM). Two respondents stress that otherwise a sufficiently long transition period for adapting the reporting frequency would be necessary, as changes to documentation requirements for clients would need to be implemented (WKO, HSBC).</p> <p>c) <u>Annually</u>: Some respondents suggest that by default a look-through should only be required on an annual basis. One respondent pointed out that most funds provide net asset value and fund distribution data only on a yearly cycle, geared to the annual review that most institutions apply to these otherwise lower-risk exposures. It is considered crucial that more time be permitted if a monitoring standard more frequent than annual is established.</p>	<p>In accordance with Article 395(3) of the CRR, institutions have to comply with the large exposures limits at all times. The EBA believes that for meeting this requirement, an institution needs to monitor the changes in the underlying assets of a transaction on a regular basis. For static portfolios, where the underlying assets do not change over time, regular monitoring will not entail additional work and will have no material additional costs. For dynamic portfolios, the treatment is more complicated as the relative portions of underlying assets as well as the composition of a transaction itself can change. In these cases, the EBA believes that it would be efficient for an institution to monitor the composition of a transaction at least monthly. The monitoring is particularly relevant for the reassessment of the materiality test.</p>	<p>Article 6(4) of the draft RTS</p>
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	<p><b>(5.4) Alternatives to defining monitoring frequency</b></p> <p>Four respondents suggest requiring the most recent available information at all times (i.e. any new information should be immediately incorporated in the Large Exposures analysis) as there is a time lag associated with receiving information that an institution cannot influence.</p> <p>Some respondents suggest that the monitoring frequency could be made dependent on the volatility and composition of a transaction.</p> <p>Some respondents suggest that the “nearness” to a Large Exposures breach should be taken into account. They deem monthly monitoring not justified in cases where the largest exposure is considerably lower than 10% of eligible capital.</p>	<p>The consideration of the most recent available data is seen as crucial, but applicable to the CRR as a whole and not specific to the large exposures framework.</p> <p>As the large exposures limits have to be complied with at all times, transactions with volatile composition should in fact be monitored more frequently. Portfolios with exposure values of minor importance for the reporting institution (see the materiality threshold in Article 6 of the draft RTS) are exempted from the look-through treatment. However, also in such cases, regular monitoring should ensure that the materiality threshold is not exceeded and the approach applied is correct over time.</p>	<p>No change</p>
	<p><b>(5.5) Exemptions from the monitoring requirement</b></p> <p>One respondent suggested that if institutions can demonstrate that their exposures in credit securitisations are far below the threshold, no monitoring of the detailed construction of their securitisation positions should be required. Another respondent suggests that exposures exempted from look-through could also be exempted from the monitoring requirement.</p> <p>Furthermore, one respondent points out that consumer data protection laws sometimes prohibit access to client data. Typically, financiers do not have access to personal information unless an asset originator becomes insolvent.</p> <p>Regarding positions held in the trading book, two</p>	<p>Monitoring should not be thought synonymous with looking-through (i.e. identifying the underlying exposures and adding them up with directly held positions to the same client or group of connected clients). If the largest exposure is “far below the threshold”, the draft RTS does not require a look-through. Instead, the transaction can be treated as individual client. However, the exemption to (full-)look-through does not justify not undertaking further monitoring of the underlying exposures.</p>	<p>No change</p>

	<p>respondents point out that the holding period is generally short. They argue that positions for which the holding period (according to the trading strategy of the institution) is less than the monitoring frequency (provided the position is not qualified as illiquid) should be exempted from the monitoring requirement.</p>		
	<p>One respondent proposes that the treatment of securitisation or investment fund structures as additional exposures should be modified so that certain contingent payment obligations typical of securitisation transactions will not require such a structure to be treated as an additional exposure, provided that the institution in question treats a portion (corresponding to the bank's proportionate investment in the transaction) of that obligation as an exposure of the bank to the payment provider (e.g. an amount equal to that portion of the facility amount or the exposure value of the derivative contract).</p>	<p>This respondent seems to criticise that contingent obligations would be considered additional exposures, which is not typically the case. However, the EBA does not believe that it would be adequate to follow the suggestion made because it would lead to a direct exposure instead of an exposure to a transaction with underlying assets.</p>	<p>No change</p>
<p><b>Question 6.</b> Are there other conditions that could be met by the structure of a transaction in order to not constitute an additional exposure according to</p>	<p>Several respondents propose that all regulated investment vehicles (authorised by an EU Member State or third country) should be excluded from the provisions of Article 7.</p>	<p>The EBA notes that the term “regulated investment vehicle” is not specific enough to give a general exemption. In the case of exposures to UCITS (and equivalent third-country undertakings) the fulfilment of the criteria in Article 7(1) can be taken as given. In all other cases, the criteria in paragraph 1 need to be assessed for determining whether the structure of the transaction constitutes an additional exposure.</p>	<p>No change</p>
	<p>One respondent proposes that a similar treatment should be applied to secured holdings, such as securitisations, provided that the appropriate ring-</p>	<p>For the treatment of exposures guaranteed by a third party, or secured by collateral issued by a third party, Article 403 of the CRR applies.</p>	<p>No change</p>

Article 7?	<p>fencing protection (e.g. bankruptcy remoteness) is available to investors. It proposed inserting the following new sub-clause:</p> <p><i>“2(c) an undertaking secured on underlying collateral under a bankruptcy remote arrangement [backed by a legal opinion].”</i></p>		
	<p>One respondent proposes extending the example provided in Article 7(2) to include investments in AIFs as defined under Article 4(1)(a) of the AIFM Directive 2011/61/EU (in a situation where the fund rules do not permit a higher level of leverage than the limit stated in Article 51(3) of the UCITS Directive, No 2009/65/EC), in order to cover undertakings established in the EU with equivalent requirements.</p>	<p>By giving a general exemption to UCITS in Article 7(2), UCITS can be taken as a reference for the assessment of the criteria in paragraph 1. However, as the structure and economic substance of transactions regulated by other legal acts can differ substantially, the EBA abstains from explicitly naming further legal acts.</p>	No change
	<p>For clarification, one respondent requests that in situations where the structure of a transaction does not present any additional risk position, there will be no need to report the structure.</p>	<p>The EBA confirms that this is the case.</p>	No change
	<p>One respondent asks for a clarifying example in relation to Article 7(1)(b). Furthermore, it pointed out that some institutions may not be able to determine whether a transaction involves a payment obligation as outlined in Article 7(1)(b), implying that they will be required to consider all transactions with underlying exposures as additional exposures.</p>	<p>The EBA deems the wording in lit. b) unambiguous. Both criteria should be assessed and met to abstain from treating the structure of a transaction as an additional exposure. If one or both of the criteria cannot be assessed and it is thus not possible to rule out any redirection of cash-flows or a contingent payment obligation, the overall investment needs to be treated as a possible concentration risk and thus limited in accordance with the large exposures rules.</p>	No change