Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)

[X1PART THREE

CAPITAL REQUIREMENTS

[X1TITLE I

GENERAL REQUIREMENTS, VALUATION AND REPORTING

CHAPTER 1

Required level of own funds

Section 1

Own funds requirements for institutions

Article 92

Own funds requirements

1 Subject to Articles 93 and 94, institutions shall at all times satisfy the following own funds requirements:

a a Common Equity Tier 1 capital ratio of 4,5 %;

b a Tier 1 capital ratio of 6 %;

c a total capital ratio of 8 %.

2 Institutions shall calculate their capital ratios as follows:

a the Common Equity Tier 1 capital ratio is the Common Equity Tier 1 capital of the institution expressed as a percentage of the total risk exposure amount;

b the Tier 1 capital ratio is the Tier 1 capital of the institution expressed as a percentage of the total risk exposure amount;

c the total capital ratio is the own funds of the institution expressed as a percentage of the total risk exposure amount.

3 Total risk exposure amount shall be calculated as the sum of points (a) to (f) of this paragraph after taking into account the provisions laid down in paragraph 4:

a the risk-weighted exposure amounts for credit risk and dilution risk, calculated in accordance with Title II and Article 379, in respect of all the business activities of an institution, excluding risk-weighted exposure amounts from the trading book business of the institution;

b the own funds requirements, determined in accordance with Title IV of this Part or Part Four, as applicable, for the trading-book business of an institution, for the following:

(i) position risk;

(ii) large exposures exceeding the limits specified in Articles 395 to 401, to the extent an institution is permitted to exceed those limits;

c the own funds requirements determined in accordance with Title IV or Title V with the exception of Article 379, as applicable, for the following:

(i) foreign-exchange risk;

(ii) settlement risk;

(iii) commodities risk;

d the own funds requirements calculated in accordance with Title VI for credit valuation adjustment risk of OTC derivative instruments other than credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk;

e the own funds requirements determined in accordance with Title III for operational risk;

f the risk-weighted exposure amounts determined in accordance with Title II for counterparty risk arising from the trading book business of the institution for the following types of transactions and agreements:

(i) contracts listed in Annex II and credit derivatives;

(ii) repurchase transactions, securities or commodities lending or borrowing transactions based on securities or commodities;

(iii) margin lending transactions based on securities or commodities;

(iv) long settlement transactions.

4 The following provisions shall apply in the calculation of the total risk exposure amount referred to in paragraph 3:

a the own funds requirements referred to in points (c), (d) and (e) of that paragraph shall include those arising from all the business activities of an institution;

b institutions shall multiply the own funds requirements set out in points (b) to (e) of that paragraph by 12,5.

I[F1 Article 92a

Requirements for own funds and eligible liabilities for G-SIIs

1 Subject to Articles 93 and 94 and to the exceptions set out in paragraph 2 of this Article, institutions identified as resolution entities and that are a G-SII or part of a G-SII shall at all times satisfy the following requirements for own funds and eligible liabilities:

a a risk-based ratio of 18 %, representing the own funds and eligible liabilities of the institution expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) and (4);

b a non-risk-based ratio of 6,75 %, representing the own funds and eligible liabilities of the institution expressed as a percentage of the total exposure measure referred to in Article 429(4).

2 The requirements laid down in paragraph 1 shall not apply in the following cases:

a within the three years following the date on which the institution or the group of which the institution is part has been identified as a G-SII;

b within the two years following the date on which the resolution authority has applied the bail-in tool in accordance with Directive 2014/59/EU;

c within the two years following the date on which the resolution entity has put in place an alternative private sector measure referred to in point (b) of Article 32(1) of Directive 2014/59/EU by which capital instruments and other liabilities have been written down or converted into Common Equity Tier 1 items in order to recapitalise the resolution entity without the application of resolution tools.

3 Where the aggregate resulting from the application of the requirement laid down in point (a) of paragraph 1 of this Article to each resolution entity of the same G SII exceeds the requirement for own funds and eligible liabilities calculated in accordance with Article 12a of this Regulation, the resolution authority of the EU parent institution may, after having consulted the other relevant resolution authorities, act in accordance with Article 45d(4) or 45h(1) of Directive 2014/59/EU.

Textual Amendments

F1 Inserted by Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (Text with EEA relevance).

Article 92b

Requirement for own funds and eligible liabilities for non-EU G-SIIs

1 Institutions that are material subsidiaries of non-EU G-SIIs and that are not resolution entities shall at all times satisfy requirements for own funds and eligible liabilities equal to 90 % of the requirements for own funds and eligible liabilities laid down in Article 92a.

2 For the purpose of complying with paragraph 1, Additional Tier 1, Tier 2 and eligible liabilities instruments shall only be taken into account where those instruments are owned by the ultimate parent undertaking of the non-EU G-SII and have been issued directly or indirectly through other entities within the same group, provided that all such entities are established in the same third country as that ultimate parent undertaking or in a Member State.

3 An eligible liabilities instrument shall only be taken into account for the purpose of complying with paragraph 1 where it fulfils all the following additional conditions:

a in the event of normal insolvency proceedings as defined in point (47) of Article 2(1) of Directive 2014/59/EU, the claim resulting from the liability ranks below claims resulting from liabilities that do not fulfil the conditions set out in paragraph 2 of this Article and that do not qualify as own funds;

b it is subject to the write-down or conversion powers in accordance with Articles 59 to 62 of Directive 2014/59/EU.**]**

Textual Amendments

F1 Inserted by Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to

central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (Text with EEA relevance).

Article 93

Initial capital requirement on going concern

1 The own funds of an institution may not fall below the amount of initial capital required at the time of its authorisation.

2 Credit institutions that were already in existence on 1 January 1993, the amount of own funds of which do not attain the amount of initial capital required may continue to carry out their activities. In that event, the amount of own funds of those institutions may not fall below the highest level reached with effect from 22 December 1989.

3 Authorised investment firms and firms that were covered by Article 6 of Directive 2006/49/EC which were in existence before 31 December 1995, the amount of own funds of which do not attain the amount of initial capital required may continue to carry out their activities. The own funds of such firms or investment firms shall not fall below the highest reference level calculated after the date of notification contained in Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investments firms and credit institutions[(1)]. That reference level shall be the average daily level of own funds calculated over a six month period preceding the date of calculation. It shall be calculated every six months in respect of the corresponding preceding period.

4 Where control of an institution falling within the category referred to in paragraph 2 or 3 is taken by a natural or legal person other than the person who controlled the institution previously, the amount of own funds of that institution shall attain the amount of initial capital required.

5 Where there is a merger of two or more institutions falling within the category referred to in paragraph 2 or 3, the amount of own funds of the institution resulting from the merger shall not fall below the total own funds of the merged institutions at the time of the merger, as long as the amount of initial capital required has not been attained.

6 Where competent authorities consider it necessary to ensure the solvency of an institution that the requirement laid down in paragraph 1 is met, the provisions laid down in paragraphs 2 to 5 shall not apply.

Article 94

Derogation for small trading book business

1 Institutions may replace the capital requirement referred to in point (b) of Article 92(3) by a capital requirement calculated in accordance with point (a) of that paragraph in respect of their trading-book business, provided that the size of their on- and off-balance sheet trading-book business meets both the following conditions:

a it is normally less than 5 % of the total assets and EUR 15 million;

b it never exceeds 6 % of total assets and EUR 20 million.

2 In calculating the size of on- and off-balance sheet business, institutions shall apply the following:

a debt instruments shall be valued at their market prices or their nominal values, equities at their market prices and derivatives according to the nominal or market values of the instruments underlying them;

b the absolute value of long positions shall be summed with the absolute value of short positions.

3 Where an institution fails to meet the condition in point (b) of paragraph 1 it shall immediately notify the competent authority. If, following assessment by the competent authority, the competent authority determines and notifies the institution that the requirement in point (a) of paragraph 1 is not met, the institution shall cease to make use of paragraph 1 from the next reporting date.

Section 2

Own funds requirements for investment firms with limited authorisation to provide investment services

Article 95

Own funds requirements for investment firms with limited authorisation to provide investment services

1 For the purposes of Article 92(3), investment firms that are not authorised to provide the investment services and activities listed in points (3) and (6) of Section A of Annex I to Directive 2004/39/EC shall use the calculation of the total risk exposure amount specified in paragraph 2.

2 Investment firms referred to in paragraph 1 of this Article and firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC shall calculate the total risk exposure amount as the higher of the following:

a the sum of the items referred to in points (a) to (d) and (f) of Article 92(3) after applying Article 92(4);

b 12,5 multiplied by the amount specified in Article 97.

Firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC shall meet the requirements in Article 92(1) and (2) based on the total risk exposure amount referred to in the first subparagraph.

Competent authorities may set the own funds requirements for firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC as the own funds requirements that would be binding on those firms according to the national transposition measures in force on 31 December 2013 for Directives 2006/49/EC and 2006/48/EC.

3 Investment firms referred to in paragraph 1 are subject to all other provisions regarding operational risk laid down in Title VII, Chapter 2, Section II, Sub-section 2 of Directive 2013/36/EU.

Article 96

Own funds requirements for investment firms which hold initial capital as laid down in Article 28(2) of Directive 2013/36/EU

1 For the purposes of Article 92(3), the following categories of investment firm which hold initial capital in accordance with Article 28(2) of Directive 2013/36/EU shall use the calculation of the total risk exposure amount specified in paragraph 2 of this Article:

a investment firms that deal on own account only for the purpose of fulfilling or executing a client order or for the purpose of gaining entrance to a clearing and settlement system or a recognised exchange when acting in an agency capacity or executing a client order;

b investment firms that meet all the following conditions:

(i) they do not hold client money or securities;

(ii) they undertake only dealing on own account;

(iii) they have no external customers;

(iv) their execution and settlement transactions take place under the responsibility of a clearing institution and are guaranteed by that clearing institution.

2 For investment firms referred to in paragraph 1, total risk exposure amount shall be calculated as the sum of the following:

a points (a) to (d) and (f) of Article 92(3) after applying Article 92(4);

b the amount referred to in Article 97 multiplied by 12,5.

3 Investment firms referred to in paragraph 1 are subject to all other provisions regarding operational risk laid down in Title VII, Chapter 3, Section II, Sub-section 1 of Directive 2013/36/EU.

Article 97

Own Funds based on Fixed Overheads

1 In accordance with Articles 95 and 96, an investment firm and firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC shall hold eligible capital of at least one quarter of the fixed overheads of the preceding year.

2 Where there is a change in the business of an investment firm since the preceding year that the competent authority considers to be material, the competent authority may adjust the requirement laid down in paragraph 1.

3 Where an investment firm has not completed business for one year, starting from the day it starts up, an investment firm shall hold eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the competent authority requires the business plan to be adjusted.

4 EBA in consultation with ESMA shall develop draft regulatory technical standards to specify in greater detail the following:

a the calculation of the requirement to hold eligible capital of at least one quarter of the fixed overheads of the previous year;

b the conditions for the adjustment by the competent authority of the requirement to hold eligible capital of at least one quarter of the fixed overheads of the previous year;

c the calculation of projected fixed overheads in the case of an investment firm that has not completed business for one year.

EBA shall submit those draft regulatory technical standards to the Commission by 1 March 2014.

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

Article 98

Own funds for investment firms on a consolidated basis

1 In the case of the investment firms referred to in Article 95(1) in a group, where that group does not include credit institutions, a parent investment firm in a Member State shall apply Article 92 at a consolidated level as follows:

a using the calculation of total risk exposure amount specified in Article 95(2);

b own funds calculated on the basis of the consolidated situation of the parent investment firm or that of the financial holding company or mixed financial holding company, as applicable.

2 In the case of investment firms referred to in Article 96(1) in a group, where that group does not include credit institutions, a parent investment firm in a Member State and an investment firm controlled by a financial holding company or mixed financial holding company shall apply Article 92 on a consolidated basis as follows:

a it shall use the calculation of total risk exposure amount specified in Article 96(2);

b it shall use own funds calculated on the basis of the consolidated situation of the parent investment firm or that of the financial holding company or mixed financial holding company, as applicable, and in compliance with Chapter 2 of Title II of Part One.

CHAPTER 2

Calculation and reporting requirements

Article 99

Reporting on own funds requirements and financial information

1 Reporting by institutions to the competent authorities on the obligations laid down in Article 92 shall be carried out at least on a semi-annual basis.

2 Institutions subject to Article 4 of Regulation (EC) No 1606/2002 and credit institutions other than those referred to in Article 4 of that Regulation that prepare their consolidated accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2) of that Regulation, shall also report financial information.

3 Competent authorities may require those credit institutions applying international accounting standards as applicable under Regulation (EC) No 1606/2002 for the reporting of

own funds on a consolidated basis pursuant to Article 24(2) of this Regulation to also report financial information as laid down in paragraph 2 of this Article.

4 The financial information referred to in paragraphs 2 and 3 shall be reported to the extent this is necessary to obtain a comprehensive view of the risk profile of an institution's activities and a view on the systemic risks posed by institutions to the financial sector or the real economy in accordance with Regulation (EU) No 1093/2010.

5 EBA shall develop draft implementing technical standards to specify the uniform formats, frequencies, dates of reporting, definitions and the IT solutions to be applied in the Union for the reporting referred to in paragraphs 1 to 4.

The reporting requirements shall be proportionate to the nature, scale and complexity of the activities of the institutions.

EBA shall submit those draft implementing technical standards to the Commission by 28 July 2013.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1093/2010.

6 Where a competent authority considers that the financial information required by paragraph 2 is necessary to obtain a comprehensive view of the risk profile of the activities of, and a view of the systemic risks to the financial sector or the real economy posed by, institutions other than those referred to in paragraphs 2 and 3 that are subject to an accounting framework based on Directive 86/635/EEC, the competent authority shall consult EBA on the extension of the reporting requirements of financial information on a consolidated basis to those institutions, provided that they are not already reporting on such a basis.

EBA shall develop draft implementing technical standards to specify the formats to be used by institutions to which the competent authorities may extend the reporting requirements in accordance with the first subparagraph.

EBA shall submit those draft implementing technical standards to the Commission by 28 July 2013.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the second subparagraph in accordance with Article 15 of Regulation (EU) No 1093/2010.

7 Where a competent authority considers information not covered by the implementing technical standards referred to in paragraph 5 to be necessary for the purposes set out in paragraph 4, it shall notify EBA and the ESRB of the additional information it deems necessary to include in the implementing technical standards referred to in paragraph 5.

Article 100

Additional reporting requirements

Institutions shall report to the competent authorities the level, at least in aggregate terms, of their repurchase agreements, securities lending and all forms of encumbrance of assets.

EBA shall include this information in the implementing technical standards on reporting referred to in Article 99(5).

Article 101

Specific reporting obligations

1 Institutions shall report on a semi-annual basis the following data to the competent authorities for each national immovable property market to which they are exposed:

a losses stemming from exposures for which an institution has recognised residential property as collateral, up to the lower of the pledged amount and 80 % of the market value or 80 % of the mortgage lending value unless otherwise decided under Article 124(2);

b overall losses stemming from exposures for which an institution has recognised residential property as collateral, up to the part of the exposure treated as fully secured by residential property in accordance with Article 124(1);

c the exposure value of all outstanding exposures for which an institution has recognised residential property as collateral limited to the part treated as fully secured by residential property in accordance with Article 124(1);

d losses stemming from exposures for which an institution has recognised immovable commercial property as collateral, up to the lower of the pledged amount and 50 % of the market value or 60 % of the mortgage lending value unless otherwise decided under Article 124(2);

e overall losses stemming from exposures for which an institution has recognised immovable commercial property as collateral, up to the part of the exposure treated as fully secured by immovable commercial property in accordance with Article 124(1).

f the exposure value of all outstanding exposures for which an institution has recognised immovable commercial property as collateral limited to the part treated as fully secured by immovable commercial property in accordance with Article 124(1).

2 The data referred to in paragraph 1 shall be reported to the competent authority of the home Member State of the relevant institution. Where an institution has a branch in another Member State, the data relating to that branch shall also be reported to the competent authorities of the host Member State. The data shall be reported separately for each immovable property market within the Union to which the relevant institution is exposed.

3 The competent authorities shall publish annually on an aggregated basis the data specified in points (a) to (f) of paragraph 1, together with historical data, where available. A competent authority shall, upon the request of another competent authority in a Member State or EBA provide to that competent authority or EBA more detailed information on the condition of the residential property or commercial immovable property markets in that Member State.

4 EBA shall develop draft implementing technical standards to specify the following:

a uniform formats, definitions, frequencies and dates of reporting, as well as the IT solutions, of the items referred to in paragraph 1;

b uniform formats, definitions, frequencies and dates of reporting, as well as IT solutions, of the aggregate data referred to in paragraph 2.

EBA shall submit those draft implementing technical standards to the Commission by 28 July 2013.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1093/2010.

CHAPTER 3

Trading book

Article 102

Requirements for the trading book

1 Positions in the trading book shall be either free of restrictions on their tradability or able to be hedged.

2 Trading intent shall be evidenced on the basis of the strategies, policies and procedures set up by the institution to manage the position or portfolio in accordance with Article 103.

3 Institutions shall establish and maintain systems and controls to manage their trading book in accordance with Articles 104 and 105.

4 Institutions may include internal hedges in the calculation of capital requirements for position risk provided that they are held with trading intent and that the requirements of Articles 103 to 106 are met.

Article 103

Management of the trading book

In managing its positions or sets of positions in the trading book the institution shall comply with all of the following requirements:

(a) the institution shall have in place a clearly documented trading strategy for the position/instrument or portfolios, approved by senior management, which shall include the expected holding period;

(b) the institution shall have in place clearly defined policies and procedures for the active management of positions entered into on a trading desk. Those policies and procedures shall include the following:

  (i) which positions may be entered into by which trading desk;

  (ii) position limits are set and monitored for appropriateness;

  (iii) dealers have the autonomy to enter into and manage the position within agreed limits and according to the approved strategy;

  (iv) positions are reported to senior management as an integral part of the institution's risk management process;

  (v) positions are actively monitored with reference to market information sources and an assessment made of the marketability or hedgeability of the position or its component risks, including the assessment, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market;

  (vi) active anti-fraud procedures and controls.

(c) the institution shall have in place clearly defined policies and procedures to monitor the positions against the institution's trading strategy including the monitoring of turnover and positions for which the originally intended holding period has been exceeded.

Article 104

Inclusion in the trading book

1 Institutions shall have in place clearly defined policies and procedures for determining which position to include in the trading book for the purposes of calculating their capital requirements, in accordance with the requirements set out in Article 102 and the definition of trading book in accordance with point (86) of Article 4(1), taking into account the institution's risk management capabilities and practices. The institution shall fully document its compliance with these policies and procedures and shall subject them to periodic internal audit.

2 Institutions shall have in place clearly defined policies and procedures for the overall management of the trading book. These policies and procedures shall at least address:

a the activities the institution considers to be trading and as constituting part of the trading book for own funds requirement purposes;

b the extent to which a position can be marked-to-market daily by reference to an active, liquid two-way market;

c for positions that are marked-to-model, the extent to which the institution can:

(i) identify all material risks of the position;

(ii) hedge all material risks of the position with instruments for which an active, liquid two-way market exists;

(iii) derive reliable estimates for the key assumptions and parameters used in the model;

d the extent to which the institution can, and is required to, generate valuations for the position that can be validated externally in a consistent manner;

e the extent to which legal restrictions or other operational requirements would impede the institution's ability to effect a liquidation or hedge of the position in the short term;

f the extent to which the institution can, and is required to, actively manage the risks of positions within its trading operation;

g the extent to which the institution may transfer risk or positions between the non-trading and trading books and the criteria for such transfers.

[F1 Article 104b

Requirements for trading desk

1 For the purposes of the reporting requirements set out in Article 430b(3), institutions shall establish trading desks and shall assign each of their trading book positions to one of those trading desks. Trading book positions shall be attributed to the same trading desk only where they satisfy the agreed business strategy for the trading desk and are consistently managed and monitored in accordance with paragraph 2 of this Article.

2 Institutions' trading desks shall at all times meet all the following requirements:

a each trading desk shall have a clear and distinctive business strategy and a risk management structure that is adequate for its business strategy;

b each trading desk shall have a clear organisational structure; positions in a given trading desk shall be managed by designated dealers within the institution; each dealer shall have dedicated functions in the trading desk; each dealer shall be assigned to one trading desk only;

c position limits shall be set within each trading desk according to the business strategy of that trading desk;

d reports on the activities, profitability, risk management and regulatory requirements at the trading desk level shall be produced at least on a weekly basis and communicated to the management body on a regular basis;

e each trading desk shall have a clear annual business plan including a well-defined remuneration policy on the basis of sound criteria used for performance measurement;

f reports on maturing positions, intra-day trading limit breaches, daily trading limit breaches and actions taken by the institution to address those breaches, as well as assessments of market liquidity, shall be prepared for each trading desk on a monthly basis and made available to the competent authorities.

3 By way of derogation from point (b) of paragraph 2, an institution may assign a dealer to more than one trading desk, provided that the institution demonstrates to the satisfaction of its competent authority that the assignment has been made due to business or resource considerations and the assignment preserves the other qualitative requirements set out in this Article applicable to dealers and trading desks.

4 Institutions shall notify the competent authorities of the manner in which they comply with paragraph 2. Competent authorities may require an institution to change the structure or organisation of its trading desks to comply with this Article.**]**

Textual Amendments

F1 Inserted by Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (Text with EEA relevance).

Article 105

Requirements for prudent valuation

1 All trading book positions shall be subject to the standards for prudent valuation specified in this Article. Institutions shall in particular ensure that the prudent valuation of their trading book positions achieves an appropriate degree of certainty having regard to the dynamic nature of trading book positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions.

2 Institutions shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates. Those systems and controls shall include at least the following elements:

a documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the institution's assumptions of what market participants would use in pricing the position, frequency of independent valuation,

timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures;

b reporting lines for the department accountable for the valuation process that are clear and independent of the front office, which shall ultimately be to the management body.

3 Institutions shall revalue trading book positions at least daily.

4 Institutions shall mark their positions to market whenever possible, including when applying trading book capital treatment.

5 When marking to market, an institution shall use the more prudent side of bid and offer unless the institution can close out at mid market. Where institutions make use of this derogation, they shall every six months inform their competent authorities of the positions concerned and furnish evidence that they can close out at mid-market.

6 Where marking to market is not possible, institutions shall conservatively mark to model their positions and portfolios, including when calculating own funds requirements for positions in the trading book.

7 Institutions shall comply with the following requirements when marking to model:

a senior management shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the materiality of the uncertainty thereby created in the reporting of the risk/performance of the business;

b institutions shall source market inputs, where possible, in line with market prices, and shall assess the appropriateness of the market inputs of the particular position being valued and the parameters of the model on a frequent basis;

c where available, institutions shall use valuation methodologies which are accepted market practice for particular financial instruments or commodities;

d where the model is developed by the institution itself, it shall be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process;

e institutions shall have in place formal change control procedures and shall hold a secure copy of the model and use it periodically to check valuations;

f risk management shall be aware of the weaknesses of the models used and how best to reflect those in the valuation output; and

g institutions' models shall be subject to periodic review to determine the accuracy of their performance, which shall include assessing the continued appropriateness of assumptions, analysis of profit and loss versus risk factors, and comparison of actual close out values to model outputs.

For the purposes of point (d), the model shall be developed or approved independently of the trading desk and shall be independently tested, including validation of the mathematics, assumptions and software implementation.

8 Institutions shall perform independent price verification in addition to daily marking to market or marking to model. Verification of market prices and model inputs shall be performed by a person or unit independent from persons or units that benefit from the trading book, at least monthly, or more frequently depending on the nature of the market or trading activity. Where independent pricing sources are not available or pricing sources are more subjective, prudent measures such as valuation adjustments may be appropriate.

9 Institutions shall establish and maintain procedures for considering valuation adjustments.

10 Institutions shall formally consider the following valuation adjustments: unearned credit spreads, close-out costs, operational risks, market price uncertainty, early termination, investing and funding costs, future administrative costs and, where relevant, model risk.

11 Institutions shall establish and maintain procedures for calculating an adjustment to the current valuation of any less liquid positions, which can in particular arise from market events or institution-related situations such as concentrated positions and/or positions for which the originally intended holding period has been exceeded. Institutions shall, where necessary, make such adjustments in addition to any changes to the value of the position required for financial reporting purposes and shall design such adjustments to reflect the illiquidity of the position. Under those procedures, institutions shall consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. Those factors include the following:

a the amount of time it would take to hedge out the position or the risks within the position;

b the volatility and average of bid/offer spreads;

c the availability of market quotes (number and identity of market makers) and the volatility and average of trading volumes including trading volumes during periods of market stress;

d market concentrations;

e the ageing of positions;

f the extent to which valuation relies on marking-to-model;

g the impact of other model risks.

12 When using third party valuations or marking to model, institutions shall consider whether to apply a valuation adjustment. In addition, institutions shall consider the need to establish adjustments for less liquid positions and on an ongoing basis review their continued suitability. Institutions shall also explicitly assess the need for valuation adjustments relating to the uncertainty of parameter inputs used by models.

13 With regard to complex products, including securitisation exposures and n-th-to-default credit derivatives, institutions shall explicitly assess the need for valuation adjustments to reflect the model risk associated with using a possibly incorrect valuation methodology and the model risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

14 EBA shall develop draft regulatory technical standards to specify the conditions according to which the requirements of Article 105 shall be applied for the purposes of paragraph 1 of this Article.

EBA shall submit those draft regulatory technical standards to the Commission by 28 July 2013.

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

Article 106

Internal Hedges

1 An internal hedge shall in particular meet the following requirements:

a it shall not be primarily intended to avoid or reduce own funds requirements;

b it shall be properly documented and subject to particular internal approval and audit procedures;

c it shall be dealt with at market conditions;

d the market risk that is generated by the internal hedge shall be dynamically managed in the trading book within the authorised limits;

e it shall be carefully monitored in accordance with adequate procedures.

2 The requirements of paragraph 1 apply without prejudice to the requirements applicable to the hedged position in the non-trading book.

3 By way of derogation from paragraphs 1 and 2, when an institution hedges a non-trading book credit risk exposure or counterparty risk exposure using a credit derivative booked in its trading book using an internal hedge, the non-trading book exposure or counterparty risk exposure shall not be deemed to be hedged for the purposes of calculating risk-weighted exposure amounts unless the institution purchases from an eligible third party protection provider a corresponding credit derivative meeting the requirements for unfunded credit protection in the non-trading book. Without prejudice to point (h) of Article 299(2), where such third party protection is purchased and recognised as a hedge of a non-trading book exposure for the purposes of calculating capital requirements, neither the internal nor external credit derivative hedge shall be included in the trading book for the purposes of calculating capital requirements.**]**

Editorial Information

X1 Substituted by Corrigendum to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

(1) **[**[X1]OJ L 141, 11.6.1993, p. 1.**]**

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Status:
Point in time view as at 31/01/2020.

Changes to legislation:
Regulation (EU) No 575/2013 of the European Parliament and of the Council, TITLE I is up to date with all changes known to be in force on or before 11 June 2024. There are changes that may be brought into force at a future date. Changes that have been made appear in the content and are referenced with annotations.