

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)

[<sup>X1</sup>PART THREE

**CAPITAL REQUIREMENTS**

TITLE II

**CAPITAL REQUIREMENTS FOR CREDIT RISK**

CHAPTER 3

**Internal Ratings Based Approach**

[<sup>X1</sup>Section 1

**Permission by competent authorities to use the IRB approach**

*Article 142*

**Definitions**

- 1 For the purposes of this Chapter, the following definitions shall apply:
- (1) ‘rating system’ means all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of exposures to rating grades or pools, and the quantification of default and loss estimates that have been developed for a certain type of exposures;
  - (2) ‘type of exposures’ means a group of homogeneously managed exposures which are formed by a certain type of facilities and which may be limited to a single entity or a single sub-set of entities within a group provided that the same type of exposures is managed differently in other entities of the group;
  - (3) ‘business unit’ means any separate organisational or legal entities, business lines, geographical locations;
  - (4) ‘large financial sector entity’ means any financial sector entity which meets the following conditions:
    - (a) its total assets, calculated on an individual or consolidated basis, are greater than or equal to a EUR 70 billion threshold, using the most recent audited financial statement or consolidated financial statement in order to determine asset size; and

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- (b) it is, or one of its subsidiaries is, subject to prudential regulation in the Union or to the laws of a third country which applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union;
- (5) ‘unregulated financial sector entity’ means an entity that is not a regulated financial sector entity but that performs, as its main business, one or more of the activities listed in Annex I to Directive 2013/36/EU or in Annex I to Directive 2004/39/EC;
- (6) ‘obligor grade’ means a risk category within the obligor rating scale of a rating system, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of probability of default (PD) are derived;
- (7) ‘facility grade’ means a risk category within a rating system's facility scale, to which exposures are assigned on the basis of a specified and distinct set of rating criteria, from which own estimates of LGD are derived;
- (8) ‘servicer’ means an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis.

2 For the purposes of point (4)(b) of paragraph 1 of this Article, the Commission may adopt, by way of implementing acts, and subject to the examination procedure referred to in Article 464(2), a decision as to whether a third country applies supervisory and regulatory arrangements at least equivalent to those applied in the Union. In the absence of such a decision, until 1 January 2015, institutions may continue to apply the treatment set out in this paragraph to a third country where the relevant competent authorities had approved the third country as eligible for this treatment before 1 January 2014.

### *Article 143*

#### **Permission to use the IRB Approach**

1 Where the conditions set out in this Chapter are met, the competent authority shall permit institutions to calculate their risk-weighted exposure amounts using the Internal Ratings Based Approach (hereinafter referred to as ‘IRB Approach’).

2 Prior permission to use the IRB Approach, including own estimates of LGD and conversion factors, shall be required for each exposure class and for each rating system and internal models approaches to equity exposures and for each approach to estimating LGDs and conversion factors used.

3 Institutions shall obtain the prior permission of the competent authorities for the following:

- a material changes to the range of application of a rating system or an internal models approach to equity exposures that the institution has received permission to use;
- b material changes to a rating system or an internal models approach to equity exposures that the institution has received permission to use.

The range of application of a rating system shall comprise all exposures of the relevant type of exposure for which that rating system was developed.

4 Institutions shall notify the competent authorities of all changes to rating systems and internal models approaches to equity exposures.

5 EBA shall develop draft regulatory technical standards to specify the conditions for assessing the materiality of the use of an existing rating system for other additional exposures

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not already covered by that rating system and changes to rating systems or internal models approaches to equity exposures under the IRB Approach.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2013.

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

#### *Article 144*

### **Competent authorities' assessment of an application to use an IRB Approach**

1 The competent authority shall grant permission pursuant to Article 143 for an institution to use the IRB Approach, including to use own estimates of LGD and conversion factors, only if the competent authority is satisfied that requirements laid down in this Chapter are met, in particular those laid down in Section 6, and that the systems of the institution for the management and rating of credit risk exposures are sound and implemented with integrity and, in particular, that the institution has demonstrated to the satisfaction of the competent authority that the following standards are met:

- a the institution's rating systems provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;
- b internal ratings and default and loss estimates used in the calculation of own funds requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the institution;
- c the institution has a credit risk control unit responsible for its rating systems that is appropriately independent and free from undue influence;
- d the institution collects and stores all relevant data to provide effective support to its credit risk measurement and management process;
- e the institution documents its rating systems and the rationale for their design and validates its rating systems;
- f the institution has validated each rating system and each internal models approach for equity exposures during an appropriate time period prior to the permission to use this rating system or internal models approach to equity exposures, has assessed during this time period whether the rating system or internal models approaches for equity exposures are suited to the range of application of the rating system or internal models approach for equity exposures, and has made necessary changes to these rating systems or internal models approaches for equity exposures following from its assessment;
- g the institution has calculated under the IRB Approach the own funds requirements resulting from its risk parameters estimates and is able to submit the reporting as required by Article 99;
- h the institution has assigned and continues with assigning each exposure in the range of application of a rating system to a rating grade or pool of this rating system; the institution has assigned and continues with assigning each exposure in the range of application of an approach for equity exposures to this internal models approach.

The requirements to use an IRB Approach, including own estimates of LGD and conversion factors, apply also where an institution has implemented a rating system, or model used within a rating system, that it has purchased from a third-party vendor.

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2 EBA shall develop draft regulatory technical standards to specify the assessment methodology competent authorities shall follow in assessing the compliance of an institution with the requirements to use the IRB Approach.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 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 145*

##### **Prior experience of using IRB approaches**

1 An institution applying to use the IRB Approach shall have been using for the IRB exposure classes in question rating systems that were broadly in line with the requirements set out in Section 6 for internal risk measurement and management purposes for at least three years prior to its qualification to use the IRB Approach.

2 An institution applying for the use of own estimates of LGDs and conversion factors shall demonstrate to the satisfaction of the competent authorities that it has been estimating and employing own estimates of LGDs and conversion factors in a manner that is broadly consistent with the requirements for use of own estimates of those parameters set out in Section 6 for at least three years prior to qualification to use own estimates of LGDs and conversion factors.

3 Where the institution extends the use of the IRB Approach subsequent to its initial permission, the experience of the institution shall be sufficient to satisfy the requirements of paragraphs 1 and 2 in respect of the additional exposures covered. If the use of rating systems is extended to exposures that are significantly different from the scope of the existing coverage, such that the existing experience cannot be reasonably assumed to be sufficient to meet the requirements of these provisions in respect of the additional exposures, then the requirements of paragraphs 1 and 2 shall apply separately for the additional exposures.

#### *Article 146*

##### **Measures to be taken where the requirements of this Chapter cease to be met**

Where an institution ceases to comply with the requirements laid down in this Chapter, it shall notify the competent authority and do one of the following:

- (a) present to the satisfaction of the competent authority a plan for a timely return to compliance and realise this plan within a period agreed with the competent authority;
- (b) demonstrate to the satisfaction of the competent authorities that the effect of non-compliance is immaterial.

#### *Article 147*

##### **Methodology to assign exposures to exposure classes**

1 The methodology used by the institution for assigning exposures to different exposure classes shall be appropriate and consistent over time.

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- 2 Each exposure shall be assigned to one of the following exposure classes:
  - a exposures to central governments and central banks;
  - b exposures to institutions;
  - c exposures to corporates;
  - d retail exposures;
  - e equity exposures;
  - f items representing securitisation positions;
  - g other non credit-obligation assets.
- 3 The following exposures shall be assigned to the class laid down in point (a) of paragraph 2:
  - a exposures to regional governments, local authorities or public sector entities which are treated as exposures to central governments under Articles 115 and 116;
  - b exposures to multilateral development banks referred to in Article 117(2);
  - c exposures to International Organisations which attract a risk weight of 0 % under Article 118.
- 4 The following exposures shall be assigned to the class laid down in point (b) of paragraph 2:
  - a exposures to regional governments and local authorities which are not treated as exposures to central governments in accordance with Article 115(2) and (4);
  - b exposures to public sector entities which are not treated as exposures to central governments in accordance with Article 116(4);
  - c exposures to multilateral development banks which are not assigned a 0 % risk weight under Article 117; and
  - d exposures to financial institutions which are treated as exposures to institutions in accordance with Article 119(5).
- 5 To be eligible for the retail exposure class laid down in point (d) of paragraph 2, exposures shall meet the following criteria:
  - a they shall be one of the following:
    - (i) exposures to one or more natural persons;
    - (ii) exposures to an SME, provided in that case that the total amount owed to the institution and parent undertakings and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, but excluding exposures secured on residential property collateral, shall not, to the knowledge of the institution, which shall have taken reasonable steps to confirm the situation, exceed EUR 1 million;
  - b they are treated by the institution in its risk management consistently over time and in a similar manner;
  - c they are not managed just as individually as exposures in the corporate exposure class;
  - d they each represent one of a significant number of similarly managed exposures.

In addition to the exposures listed in the first subparagraph, the present value of retail minimum lease payments shall be included in the retail exposure class.

- 6 The following exposures shall be assigned to the equity exposure class laid down in point (e) of paragraph 2:
  - a non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;

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- b debt exposures and other securities, partnerships, derivatives, or other vehicles, the economic substance of which is similar to the exposures specified in point (a).

7 Any credit obligation not assigned to the exposure classes laid down in points (a), (b), (d), (e) and (f) of paragraph 2 shall be assigned to the corporate exposure class referred to in point (c) of that paragraph.

8 Within the corporate exposure class laid down in point (c) of paragraph 2, institutions shall separately identify as specialised lending exposures, exposures which possess the following characteristics:

- a the exposure is to an entity which was created specifically to finance or operate physical assets or is an economically comparable exposure;
- b the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate;
- c the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

9 The residual value of leased properties shall be assigned to the exposure class laid down in point (g) of paragraph 2, except to the extent that residual value is already included in the lease exposure laid down in Article 166(4).

10 The exposure from providing protection under an nth-to-default basket credit derivative shall be assigned to the same class laid down in paragraph 2 to which the exposures in the basket would be assigned, except if the individual exposures in the basket would be assigned to various exposure classes in which case the exposure shall be assigned to the corporates exposure class laid down in point (c) of paragraph 2.

#### *Article 148*

### **Conditions for implementing the IRB Approach across different classes of exposure and business units**

1 Institutions and any parent undertaking and its subsidiaries shall implement the IRB Approach for all exposures, unless they have received the permission of the competent authorities to permanently use the Standardised Approach in accordance with Article 150.

Subject to the prior permission of the competent authorities, implementation may be carried out sequentially across the different exposure classes referred to in Article 147 within the same business unit, across different business units in the same group or for the use of own estimates of LGDs or conversion factors for the calculation of risk weights for exposures to corporates, institutions, and central governments and central banks.

In the case of the retail exposure class referred to in Article 147(5), implementation may be carried out sequentially across the categories of exposures to which the different correlations in Article 154 correspond.

2 Competent authorities shall determine the time period over which an institution and any parent undertaking and its subsidiaries shall be required to implement the IRB Approach for all exposures. This time period shall be one that competent authorities consider to be appropriate on the basis of the nature and scale of the activities of the institutions, or any parent undertaking and its subsidiaries, and the number and nature of rating systems to be implemented.

3 Institutions shall carry out implementation of the IRB Approach in accordance with conditions determined by the competent authorities. The competent authority shall design those

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conditions such that they ensure that the flexibility under paragraph 1 is not used selectively for the purposes of achieving reduced own funds requirements in respect of those exposure classes or business units that are yet to be included in the IRB Approach or in the use of own estimates of LGDs and conversion factors.

4 Institutions that have begun to use the IRB Approach only after 1 January 2013 or that have until that date been required by the competent authorities to be able to calculate their capital requirements using the Standardised Approach shall retain their ability to calculate capital requirements using the Standardised Approach for all their exposures during the implementation period until the competent authorities notify them that they are satisfied that the implementation of the IRB Approach will be completed with reasonable certainty.

5 An institution that is permitted to use the IRB Approach for any exposure class shall use the IRB Approach for the equity exposure class laid down in point (e) of Article 147(2), except where that institution is permitted to apply the Standardised Approach for equity exposures pursuant to Article 150 and for the other non credit-obligation assets exposure class laid down in point (g) of Article 147(2).

6 EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall determine the appropriate nature and timing of the sequential roll out of the IRB Approach across exposure classes referred to in paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 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 149*

##### **Conditions to revert to the use of less sophisticated approaches**

1 An institution that uses the IRB Approach for a particular exposure class or type of exposure shall not stop using that approach and use instead the Standardised Approach for the calculation of risk-weighted exposure amounts unless the following conditions are met:

- a the institution has demonstrated to the satisfaction of the competent authority that the use of the Standardised Approach is not proposed in order to reduce the own funds requirement of the institution, is necessary on the basis of nature and complexity of the institution's total exposures of this type and would not have a material adverse impact on the solvency of the institution or its ability to manage risk effectively;
- b the institution has received the prior permission of the competent authority.

2 Institutions which have obtained permission under Article 151(9) to use own estimates of LGDs and conversion factors, shall not revert to the use of LGD values and conversion factors referred to in Article 151(8) unless the following conditions are met:

- a the institution has demonstrated to the satisfaction of the competent authority that the use of LGDs and conversion factors laid down in Article 151(8) for a certain exposure class or type of exposure is not proposed in order to reduce the own funds requirement of the institution, is necessary on the basis of nature and complexity of the institution's total exposures of this type and would not have a material adverse impact on the solvency of the institution or its ability to manage risk effectively;
- b the institution has received the prior permission of the competent authority.

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3 The application of paragraphs 1 and 2 is subject to the conditions for rolling out the IRB Approach determined by the competent authorities in accordance with Article 148 and the permission for permanent partial use referred to in Article 150.

### *Article 150*

#### **Conditions for permanent partial use**

1 Where institutions have received the prior permission of the competent authorities, institutions permitted to use the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes may apply the Standardised Approach for the following exposures:

- a the exposure class laid down in Article 147(2)(a), where the number of material counterparties is limited and it would be unduly burdensome for the institution to implement a rating system for these counterparties;
- b the exposure class laid down in Article 147(2)(b), where the number of material counterparties is limited and it would be unduly burdensome for the institution to implement a rating system for these counterparties;
- c exposures in non-significant business units as well as exposure classes or types of exposures that are immaterial in terms of size and perceived risk profile;
- d exposures to central governments and central banks of the Member States and their regional governments, local authorities, administrative bodies and public sector entities provided that:
  - (i) there is no difference in risk between the exposures to that central government and central bank and those other exposures because of specific public arrangements; and
  - (ii) exposures to the central government and central bank are assigned a 0 % risk weight under Article 114(2) or (4) or Article 495(2);
- e exposures of an institution to a counterparty which is its parent undertaking, its subsidiary or a subsidiary of its parent undertaking provided that the counterparty is an institution or a financial holding company, mixed financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements or an undertaking linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC;
- f exposures between institutions which meet the requirements set out in Article 113(7);
- g equity exposures to entities whose credit obligations are assigned a 0 % risk weight under Chapter 2 including those publicly sponsored entities where a 0 % risk weight can be applied;
- h equity exposures incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the institution and involve some form of government oversight and restrictions on the equity investments where such exposures may in aggregate be excluded from the IRB Approach only up to a limit of 10 % of own funds;
- i the exposures identified in Article 119(4) meeting the conditions specified therein;
- j State and State-reinsured guarantees referred to in Article 215(2).

The competent authorities shall permit the application of Standardised Approach for equity exposures referred to in points (g) and (h) of the first subparagraph which have been permitted for that treatment in other Member States. EBA shall publish on its



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website and regularly update a list of the exposures referred to in those points to be treated according to the Standardised Approach.

2 For the purposes of paragraph 1, the equity exposure class of an institution shall be material if their aggregate value, excluding equity exposures incurred under legislative programmes as referred to in point (h) of paragraph 1, exceeds on average over the preceding year 10 % of the own funds of the institution. Where the number of those equity exposures is less than 10 individual holdings, that threshold shall be 5 % of the own funds of the institution.

3 EBA shall develop draft regulatory technical standards to determine the conditions of application of points (a), (b) and (c) of paragraph 1.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 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.

4 EBA shall issue guidelines on the application of point (d) of paragraph 1 in 2018, recommending limits in terms of a percentage of total balance sheet and/or risk weighted assets to be calculated in accordance with the Standardised Approach.

Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.]

#### **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 \(OJ L 176, 27.6.2013, p. 1\)](#).

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