

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)

PART THREE

CAPITAL REQUIREMENTS

TITLE II

CAPITAL REQUIREMENTS FOR CREDIT RISK

CHAPTER 4

Credit risk mitigation

Section 2

Eligible forms of credit risk mitigation

Sub-Section 1

Funded credit protection

Article 195

On-balance sheet netting

An institution may use on-balance sheet netting of mutual claims between itself and its counterparty as an eligible form of credit risk mitigation.

Without prejudice to Article 196, eligibility is limited to reciprocal cash balances between the institution and the counterparty. Institutions may amend risk-weighted exposure amounts and, as relevant, expected loss amounts only for loans and deposits that they have received themselves and that are subject to an on-balance sheet netting agreement.

Article 196

**Master netting agreements covering repurchase transactions
or securities or commodities lending or borrowing
transactions or other capital market-driven transactions**

Institutions adopting the Financial Collateral Comprehensive Method set out in Article 223 may take into account the effects of bilateral netting contracts covering repurchase transactions, securities or commodities lending or borrowing transactions, or other

capital market-driven transactions with a counterparty. Without prejudice to Article 299, the collateral taken and securities or commodities borrowed within such agreements or transactions shall comply with the eligibility requirements for collateral set out in Articles 197 and 198.

Article 197

Eligibility of collateral under all approaches and methods

1 Institutions may use the following items as eligible collateral under all approaches and methods:

- a cash on deposit with, or cash assimilated instruments held by, the lending institution;
- b debt securities issued by central governments or central banks, which securities have a credit assessment by an ECAI or export credit agency recognised as eligible for the purposes of Chapter 2 which has been determined by EBA to be associated with credit quality step 4 or above under the rules for the risk weighting of exposures to central governments and central banks under Chapter 2;
- c debt securities issued by institutions, which securities have a credit assessment by an ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions under Chapter 2;
- d debt securities issued by other entities which securities have a credit assessment by an ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Chapter 2;
- e debt securities with a short-term credit assessment by an ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of short term exposures under Chapter 2;
- f equities or convertible bonds that are included in a main index;
- g gold;
- h securitisation positions that are not re-securitisation positions, which have an external credit assessment by an ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of securitisation exposures under the approach specified in Chapter 5, Section 3, Sub-section 3.

2 For the purposes of point (b) of paragraph 1, 'debt securities issued by central governments or central banks' shall include all the following:

- a debt securities issued by regional governments or local authorities, exposures to which are treated as exposures to the central government in whose jurisdiction they are established under Article 115(2);
- b debt securities issued by public sector entities which are treated as exposures to central governments in accordance with Article 116(4);
- c debt securities issued by multilateral development banks to which a 0 % risk weight is assigned under Article 117(2);
- d debt securities issued by international organisations which are assigned a 0 % risk weight under Article 118.

3 For the purposes of point (c) of paragraph 1, 'debt securities issued by institutions' shall include all the following:

- a debt securities issued by regional governments or local authorities other than those debt securities referred to in point (a) of paragraph 2;
- b debt securities issued by public sector entities, exposures to which are treated in accordance with Article 116(1) and (2);

- c debt securities issued by multilateral development banks other than those to which a 0 % risk weight is assigned under Article 117(2).

4 An institution may use debt securities that are issued by other institutions and that do not have a credit assessment by an ECAI as eligible collateral where those debt securities fulfil all the following criteria:

- a they are listed on a recognised exchange;
- b they qualify as senior debt;
- c all other rated issues by the issuing institution of the same seniority have a credit assessment by an ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions or short term exposures under Chapter 2;
- d the lending institution has no information to suggest that the issue would justify a credit assessment below that indicated in point (c);
- e the market liquidity of the instrument is sufficient for these purposes.

5 Institutions may use units or shares in CIUs as eligible collateral where all the following conditions are satisfied:

- a the units or shares have a daily public price quote;
- b the CIUs are limited to investing in instruments that are eligible for recognition under paragraphs 1 and 2;
- c the CIUs meet the conditions laid down in Article 132(3).

Where a CIU invests in shares or units of another CIU, conditions laid down in points (a) to (c) of the first subparagraph shall apply equally to any such underlying CIU.

The use by a CIU of derivative instruments to hedge permitted investments shall not prevent units or shares in that undertaking from being eligible as collateral.

6 For the purposes of paragraph 5, where a CIU ('the original CIU') or any of its underlying CIUs are not limited to investing in instruments that are eligible under paragraphs 1 and 4, institutions may use units or shares in that CIU as collateral to an amount equal to the value of the eligible assets held by that CIU under the assumption that that CIU or any of its underlying CIUs have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

Where any underlying CIU has underlying CIUs of its own, institutions may use units or shares in the original CIU as eligible collateral provided that they apply the methodology laid down in the first subparagraph

Where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, institutions shall do both of the following:

- a calculate the total value of the non-eligible assets;
- b where the amount obtained under point (a) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

7 With regard to points (b) to (e) of paragraph 1, where a security has two credit assessments by ECAIs, institutions shall apply the less favourable assessment. Where a security has more than two credit assessments by ECAIs, institutions shall apply the two most favourable assessments. Where the two most favourable credit assessments are different, institutions shall apply the less favourable of the two.

8 ESMA shall develop draft implementing technical standards to specify the following:

- a the main indices referred to in point (f) of paragraph 1 of this Article, in point (a) of Article 198(1), in Article 224(1) and (4), and in point (e) of Article 299(2);
- b the recognised exchanges referred to in point (a) of paragraph 4 of this Article, in point (a) of Article 198(1), in Article 224(1) and (4), in point (e) of Article 299(2), in point (k) of Article 400(2), in point (e) of Article 416(3), in point (c) of Article 428(1), and in point 12 of Annex III in accordance with the conditions laid down in point (72) of Article 4(1).

ESMA shall submit those draft implementing technical standards to the Commission by 31 December 2014.

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 1095/2010.

Article 198

Additional eligibility of collateral under the Financial Collateral Comprehensive Method

1 In addition to the collateral established in Article 197, where an institution uses the Financial Collateral Comprehensive Method set out in Article 223, that institution may use the following items as eligible collateral:

- a equities or convertible bonds not included in a main index but traded on a recognised exchange;
- b units or shares in CIUs where both the following conditions are met:
 - (i) the units or shares have a daily public price quote;
 - (ii) the CIU is limited to investing in instruments that are eligible for recognition under Article 197(1) and (4) and the items mentioned in point (a) of this subparagraph.

In the case a CIU invests in units or shares of another CIU, conditions (a) and (b) of this paragraph equally apply to any such underlying CIU.

The use by a CIU of derivative instruments to hedge permitted investments shall not prevent units or shares in that undertaking from being eligible as collateral.

2 Where the CIU or any underlying CIU are not limited to investing in instruments that are eligible for recognition under Article 197(1) and (4) and the items mentioned in point (a) of paragraph 1 of this Article, institutions may use units or shares in that CIU as collateral to an amount equal to the value of the eligible assets held by that CIU under the assumption that that CIU or any of its underlying CIUs have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

Where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, institutions shall do both of the following:

- a calculate the total value of the non-eligible assets;
- b where the amount obtained under point (a) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

Article 199

Additional eligibility for collateral under the IRB Approach

1 In addition to the collateral referred to in Articles 197 and 198, institutions that calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach may also use the following forms of collateral:

- a immovable property collateral in accordance with paragraphs 2, 3 and 4;
- b receivables in accordance with paragraph 5;
- c other physical collateral in accordance with paragraphs 6 and 8;
- d leasing in accordance with paragraph 7.

2 Unless otherwise specified under Article 124(2), institutions may use as eligible collateral residential property which is or will be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, and commercial immovable property, including offices and other commercial premises, where both the following conditions are met:

- a the value of the property does not materially depend upon the credit quality of the obligor. Institutions may exclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower from their determination of the materiality of such dependence;
- b the risk of the borrower does not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence the repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.

3 Institutions may derogate from point (b) of paragraph 2 for exposures secured by residential property situated within the territory of a Member State, where the competent authority of that Member State has published evidence showing that a well-developed and long-established residential property market is present in that territory with loss rates that do not exceed any of the following limits:

- a losses stemming from loans collateralised by residential property up to 80 % of the market value or 80 % of the mortgage-lending-value, unless otherwise provided under Article 124(2), do not exceed 0,3 % of the outstanding loans collateralised by residential property in any given year;
- b overall losses stemming from loans collateralised by residential property do not exceed 0,5 % of the outstanding loans collateralised by residential property in any given year.

Where either of the conditions in points (a) and (b) of the first subparagraph is not met in a given year, institutions shall not use the treatment set out in that subparagraph until both conditions are satisfied in a subsequent year.

4 Institutions may derogate from point (b) of paragraph 2 for commercial immovable property situated within the territory of a Member State, where the competent authority of that Member State has published evidence showing that a well-developed and long-established commercial property market is present in that territory with loss rates that do not exceed any of the following limits:

- a losses stemming from loans collateralised by commercial immovable property up to 50 % of the market value or 60 % of the mortgage-lending-value do not exceed 0,3 % of the outstanding loans collateralised by commercial immovable property in any given year;

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- b overall losses stemming from loans collateralised by commercial immovable property do not exceed 0,5 % of the outstanding loans collateralised by commercial immovable property in any given year.

Where either of the conditions in points (a) and (b) of the first subparagraph is not met in a given year, institutions shall not use the treatment set out in that subparagraph until both conditions are satisfied in a subsequent year.

5 Institutions may use as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.

6 Competent authorities shall permit an institution to use as eligible collateral physical collateral of a type other than those indicated in paragraphs 2, 3 and 4 where all the following conditions are met:

- a there are liquid markets, evidenced by frequent transactions taking into account the asset type, for the disposal of the collateral in an expeditious and economically efficient manner. Institutions shall carry out the assessment of this condition periodically and where information indicates material changes in the market;
- b there are well-established, publicly available market prices for the collateral. Institutions may consider market prices as well-established where they come from reliable sources of information such as public indices and reflect the price of the transactions under normal conditions. Institutions may consider market prices as publicly available, where these prices are disclosed, easily accessible, and obtainable regularly and without any undue administrative or financial burden;
- c the institution analyses the market prices, time and costs required to realise the collateral and the realised proceeds from the collateral;
- d the institution demonstrates that the realised proceeds from the collateral are not below 70 % of the collateral value in more than 10 % of all liquidations for a given type of collateral. Where there is material volatility in the market prices, the institution demonstrates to the satisfaction of the competent authorities that its valuation of the collateral is sufficiently conservative.

Institutions shall document the fulfilment of the conditions specified in points (a) to (d) of the first subparagraph and those specified in Article 210.

7 Subject to the provisions of Article 230(2), where the requirements set out in Article 211 are met, exposures arising from transactions whereby an institution leases property to a third party may be treated in the same manner as loans collateralised by the type of property leased.

8 EBA shall disclose a list of types of physical collateral for which institutions can assume that the conditions referred to in points (a) and (b) of paragraph 6 are met.

Article 200

Other funded credit protection

Institutions may use the following other funded credit protection as eligible collateral:

- (a) cash on deposit with, or cash assimilated instruments held by, a third party institution in a non-custodial arrangement and pledged to the lending institution;
- (b) life insurance policies pledged to the lending institution;

- (c) instruments issued by third party institutions which will be repurchased by that institution on request.

Sub-Section 2

Unfunded credit protection

Article 201

Eligibility of protection providers under all approaches

1 Institutions may use the following parties as eligible providers of unfunded credit protection:

- a central governments and central banks;
- b regional governments or local authorities;
- c multilateral development banks;
- d international organisations exposures to which a 0 % risk weight under Article 117 is assigned;
- e public sector entities, claims on which are treated in accordance with Article 116;
- f institutions, and financial institutions for which exposures to the financial institution are treated as exposures to institutions in accordance with Article 119(5);
- g other corporate entities, including parent, subsidiary and affiliate corporate entities of the institution, where either of the following conditions is met:
 - (i) those other corporate entities have a credit assessment by an ECAI;
 - (ii) in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, those other corporate entities do not have a credit assessment by a recognised ECAI and are internally rated by the institution;
- h central counterparties.

2 Where institutions calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach, to be eligible as a provider of unfunded credit protection a guarantor shall be internally rated by the institution in accordance with the provisions of Section 6 of Chapter 3.

Competent authorities shall publish and maintain the list of those financial institutions that are eligible providers of unfunded credit protection under point (f) of paragraph 1, or the guiding criteria for identifying such eligible providers of unfunded credit protection, together with a description of the applicable prudential requirements, and share their list with other competent authorities in accordance with Article 117 of Directive 2013/36/EU.

Article 202

Eligibility of protection providers under the IRB Approach which qualify for the treatment set out in Article 153(3)

An institution may use institutions, insurance and reinsurance undertakings and export credit agencies as eligible providers of unfunded credit protection which qualify for the treatment set out in Article 153(3) where they meet all the following conditions:

- (a) they have sufficient expertise in providing unfunded credit protection;
- (b) they are regulated in a manner equivalent to the rules laid down in this Regulation, or had, at the time the credit protection was provided, a credit assessment by a recognised ECAI which had been determined by EBA to be associated with credit quality step 3, or above, in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2;
- (c) they had, at the time the credit protection was provided, or for any period of time thereafter, an internal rating with a PD equivalent to or lower than that associated with credit quality step 2 or above in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2;
- (d) they have an internal rating with a PD equivalent to or lower than that associated with credit quality step 3 or above in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2.

For the purpose of this Article, credit protection provided by export credit agencies shall not benefit from any explicit central government counter-guarantee.

Article 203

Eligibility of guarantees as unfunded credit protection

Institutions may use guarantees as eligible unfunded credit protection.

Sub-Section 3

Types of derivatives

Article 204

Eligible types of credit derivatives

1 Institutions may use the following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, as eligible credit protection:

- a credit default swaps;
- b total return swaps;
- c credit linked notes to the extent of their cash funding.

Where an institution buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record the offsetting deterioration in the value of the asset that is protected either through reductions in fair value or by an addition to reserves, that credit protection does not qualify as eligible credit protection.

2 Where an institution conducts an internal hedge using a credit derivative, in order for the credit protection to qualify as eligible credit protection for the purposes of this Chapter, the credit risk transferred to the trading book shall be transferred out to a third party or parties.

Where an internal hedge has been conducted in accordance with the first subparagraph and the requirements in this Chapter have been met, institutions shall apply the rules set out in Sections 4 to 6 for the calculation of risk-weighted exposure amounts and expected loss amounts where they acquire unfunded credit protection.