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Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) No 1187/2014

of 2 October 2014

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012<sup>(1)</sup>, and in particular the third subparagraph of Article 390(8) thereof,

Whereas:

- (1) In order to identify the overall exposure to a particular obligor that results from the institution's exposures to a transaction with underlying assets, the exposure value should be firstly identified 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) Where exposures of other investors rank *pari passu* with the institution's exposure, the exposure value of the institution's exposure to an underlying asset should reflect the pro-rata distribution of losses amongst the exposures that rank *pari passu*. This results from the fact that if a default event has occurred for an underlying asset, losses are always distributed amongst the exposures that rank *pari passu* according to the pro-rata ratio of each of these exposures and 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*.
- (3) A distinction should be made between transactions where all investors rank *pari passu* such as collective investment undertakings, and other transactions, such as securitisations, which can involve tranching where exposures can rank differently in seniority. For the former, the resulting exposure to an underlying asset is solely dependent on the pro-rata ratio of the investor's exposure in relation to the exposures

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- of all investors. For the latter, losses are attributed first to certain tranches depending on their seniority and then, in case of more than one investor into the same tranche, amongst the investors on a pro rata basis. All tranches in a securitisation should be treated equally as, in a worst case scenario, subordinated tranches may disappear very quickly. 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. The institution's exposure to an underlying asset of a transaction should not exceed 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 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). 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 institutions are expected to identify all obligors of underlying assets of transactions in which they invest, there may be cases where this would create unjustifiable costs for institutions or where circumstances prevent institutions from identifying particular obligors. 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 should be sufficient to assign this exposure to the transaction as a separate client. The total of such exposures to underlying assets of the same transaction should then still be limited by the large exposures limit for this transaction. Immateriality of the contribution of an underlying asset to the overall exposure should be assumed where at least 100 exposures to underlying assets of a transaction are needed to reach the limit of 25 % of the institution's eligible capital. This would require that the exposure value does not exceed 0,25 % of the institution's eligible capital.
  - (5) In order to prevent an unlimited overall exposure resulting from information deficiencies, it would be 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 (unknown client) to which the 25 % large exposures' limit should apply.
  - (6) Where an institution is not able to distinguish between the underlying assets of a transaction in terms of their amount, there is a risk that the underlying assets of the transaction relate to the same obligor or group of connected clients. In this case, in order to mitigate this risk, the institution should be required to 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 client instead of the 'unknown client'.
  - (7) The structure of a transaction should not 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 of underlying assets. An additional exposure should be recognised where the transaction involves a payment obligation of a certain person

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in addition to, or at least in advance of, the cash flows from the underlying assets, given that investors could suffer additional losses in the event of default of this person although no default event has occurred for an underlying asset. An additional exposure should also be recognised where the circumstances of the transaction enable cash flows to be redirected to a person who is not entitled to receive them as investors could suffer additional losses, although no default event for an underlying asset has occurred. No additional exposure should be recognised for undertakings for collective investment in transferable securities (UCITS) as referred to in Directive 2009/65/EC of the European Parliament and of the Council<sup>(2)</sup>, given that cash flows cannot be redirected to a person who is not entitled under the transaction to receive these cash flows. This should also be assumed for entities that are subject to equivalent requirements pursuant to Union legislative acts or to legislation of a third country.

- (8) The existence and value of exposures to a client or group of connected clients resulting from exposures to transactions do not depend on whether the exposures to transactions are assigned to the trading book or the non-trading book. Therefore, the conditions and methodologies to be used for identifying exposures to transactions with underlying assets should be the same, irrespective of whether these exposures are assigned to the trading book or the non-trading book of the institution.
- (9) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority (EBA) to the Commission.
- (10) The EBA 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 of the European Parliament and of the Council<sup>(3)</sup>,

HAS ADOPTED THIS REGULATION:

**Modifications etc. (not altering text)**

- C1** The “appropriate regulator” has power to make such provision as they consider appropriate by means of an instrument in writing to prevent, remedy or mitigate any failure of the provisions of this Regulation to operate effectively or any other deficiency arising from the withdrawal of the United Kingdom from the EU, see The Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (S.I. 2018/1115), [regs. 2, 3, Sch. Pt. 4](#) (with saving on IP completion day by S.I. 2019/680, [regs. 1\(2\), 11](#); 2020 c. 1, [Sch. 5 para. 1\(1\)](#))
- C2** Regulation: power to modify conferred (11.7.2023) by [Financial Services and Markets Act 2023 \(c. 29\), ss. 3, 86\(3\), Sch. 1 Pts. 1, 3; S.I. 2023/779, reg. 2\(d\)](#)

*Article 1*

**Subject matter**

This Regulation specifies 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 and the conditions under which

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~~the structure of transactions with underlying assets does not constitute an additional exposure.~~

## Article 2

### Definitions

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

- (a) 'transactions' mean, transactions referred to in points (m) and (o) of Article 112 of Regulation (EU) No 575/2013 and other transactions where there is an exposure to underlying assets;
- (b) 'unknown client' means a single hypothetical client to which the institution assigns 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, 5 and 6.

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 in accordance with Article 7.

## 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 Paragraph 1 shall apply as long as the underlying exposures are exposures to transactions with underlying assets.

## 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.

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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 shall be 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 in cases other than those referred to point (a) the exposure value of the resulting exposure to an underlying asset shall be 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 shall be 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.

## 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 in cases other than those referred to in points (a) and (b), 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 in cases other than those referred to in point (a), it shall assign this total exposure value to the unknown client.

4 For the purposes 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.

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## Article 7

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

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

- 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 point (a) of paragraph 1 shall be considered to be met where the transaction is one of the following:

- a a UCITS as defined in Article 1(2) of Directive 2009/65/EC;
- 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

### **Entry into force**

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, 2 October 2014.

*For the Commission*

*The President*

José Manuel BARROSO

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- (1) [OJ L 176, 27.6.2013, p. 1.](#)
- (2) Directive 2009/65/EC 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) ([OJ L 302, 17.11.2009, p. 32](#)).
- (3) Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC ([OJ L 331, 15.12.2010, p. 12](#)).

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**Changes and effects yet to be applied to :**

- Regulation revoked by [2023 c. 29 Sch. 1 Pt. 13](#)

**Changes and effects yet to be applied to the whole legislation item and associated provisions**

- Pt. 2 revoked by [S.I. 2021/1078 reg. 13\(2\)\(c\)](#) (This amendment not applied to [legislation.gov.uk](#). The affected provision Pt. 2 (PRA) was modified by a non-legislative instrument ([Technical Standards \(Capital Requirements\) \(EU Exit\) \(No.3\) Instrument 2019](#)) and is not present in the text of the retained EU legislation on [legislation.gov.uk](#). Details of the non-legislative modifications can be found on the Bank of England's website on the page entitled "[The Bank of England's amendments to financial services legislation under the European Union \(Withdrawal\) Act 2018](#)".)