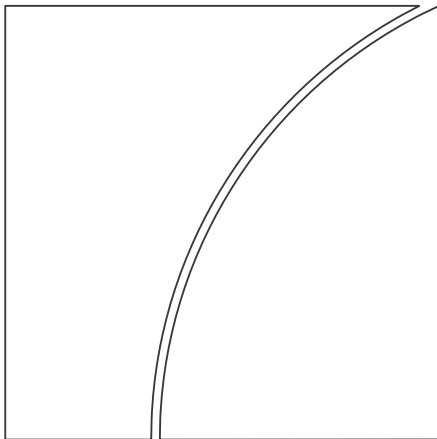


Basel Committee on Banking Supervision



Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel large exposures regulations – European Union

July 2022



Note that this report refers to the RCAP grades prior to October 2025. The grade 'materially non-compliant (MNC)', ie one notch above the lowest grade, has since been renamed to 'partially non-compliant (PNC)' for greater clarity

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Glossary

BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BTS	Binding Technical Standards
C	Compliant (grade)
CCF	Credit Conversion Factor
CRM	Credit Risk Mitigation
CRR	Capital Requirements Regulation
DGS	Deposit Guarantee Schemes
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EU	European Union
G-SIB	Global systemically important bank
IRB	Internal Ratings-Based Approach
ITS	Implementing Technical Standards
LC	Largely compliant (grade)
LEX	Large exposures
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
OSFI	Office of the Superintendent of Financial Institutions
RCAP	Regulatory Consistency Assessment Programme
RTS	Regulatory Technical Standards
SA-CCR	Standardised Approach for Counterparty Credit Risk
SSM	Single Supervisory Mechanism

Preface

The Basel Committee on Banking Supervision (Basel Committee) places a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented in a full, timely and consistent manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel III framework.¹

This report presents the findings of an RCAP Assessment Team (Assessment Team) on the adoption of the Basel large exposures (LEX) framework in the European Union (EU). The assessment focused on the completeness and consistency of the EU LEX regulations with the Basel LEX framework and relied on the information provided by the EU authorities.

The assessment began in September 2019 but was suspended in March 2020 due to Covid-19.² The assessment resumed in December 2021 with an Assessment Team led by Ben Gully, Assistant Superintendent of Regulation Sector of the Office of the Superintendent of Financial Institutions (OSFI), and comprising four technical experts, from Brazil, the Russian Federation (until February 2022), South Africa and the United States (see Annex 1). The main counterpart for the assessment was the European Commission (EC), which in turn coordinated with other EU and Member State authorities. The work was coordinated by the Basel Committee Secretariat with the support of staff from OSFI.

The assessment comprised (i) a self-assessment by the EU authorities; (ii) an assessment phase; and (iii) a review phase including a technical review of the Assessment Team's findings by a separate RCAP Review Team. The assessment report ultimately reflects the view of the Basel Committee.

The Assessment Team acknowledges the cooperation received from the EU authorities throughout the assessment process. In particular, the Assessment Team thanks (i) the staff from the EC, who ensured thorough cooperation during the assessment; (ii) the staff from the European Banking Authority (EBA) for handling the data aspects and contributing to the materiality tests; (iii) the European Central Bank (ECB) and the Single Supervisory Mechanism (SSM); and (iv) the Basel Committee members from the EU Member States (Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain and Sweden) along with their respective banks that participated in the assessment.

¹ See www.bis.org/bcbs/implementation.htm.

² See www.bis.org/press/p200320.htm.

Executive summary

In the EU, the LEX requirements were first introduced through Regulation (EU) No 575/2013, and then amended for improved alignment with the Basel LEX framework through Regulation (EU) 2019/876, supplemented by a series of acts adopted by the EC and Guidelines issued by the EBA. The amendment to LEX requirements was published on 7 June 2019 and became applicable from 28 June 2021.

Overall, as of end-March 2022, the LEX regulations in the EU are assessed as largely compliant with the Basel LEX standards. This is one notch below the highest overall grade.

The three components of the Basel LEX standard (scope and definitions; minimum requirements and transitional arrangements; and value of exposures) are assessed as compliant, largely compliant and compliant, respectively.

The overall grade is driven by a potentially material finding related to the limit applicable to trading book exposures and nine findings that were deemed not material. For trading book exposures, the EU regulations allow for the LEX limit to be exceeded up to 600% of a bank's Tier 1 capital.

In addition, this report identified an item for follow-up assessment (see Annex 4). It was noted that the EC has proposed an amendment to the current provisions on the possibility of using own volatility estimates via the deletion of the corresponding provisions in the CRR, which should be subject to review in a future RCAP assessment.

The Assessment Team noted that the LEX regulations in the EU are super-equivalent to the Basel LEX framework in one area (see Annex 5). In accordance with the methodology and guidance provided in the RCAP Handbook for jurisdictional assessments, the stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

Response from the EU authorities

The European Commission and the European Banking Authority sincerely thank Mr Ben Gully and the Assessment Team for their work on the present report. We appreciate the thorough comparison of Basel standards and EU law and commend the professionalism and rigour that the whole Assessment Team demonstrated, which ensured constructive and thorough discussions on the implementation of the Basel LEX standard in the EU context.

We welcome and share the assessment that the implementation of the large exposure rules in the EU is largely compliant with the Basel LEX standard.

As documented in the report, a small number of deviations from the Basel LEX standard were introduced in EU legislation to cater for certain EU specificities, reflecting the fact that large exposure limits apply to banks of all sizes and to certain investment firms. For the most part, these deviations are not used by the banks in the RCAP sample and, in the very few cases where they are used, the impacts are immaterial, as the report confirms.

One finding relates to the possibility for banks to have a higher large exposure limit for their trading book exposures. As acknowledged in the report, no bank in the sample has used this possibility in recent years, despite a number of stress events that have impacted their trading book exposures. While one cannot exclude the possibility that a bank in the sample will use this possibility in the future, the safeguards attached to it (immediate reporting to competent authorities, additional capital requirements of up to 900% depending on the duration and size of the large exposure compared with the standard limit) and the fact that the size of the trading book exposures of the banks in the sample is relatively small compared with the size of their total exposures, make it highly unlikely that a bank would use this possibility to such an extent that its soundness would be jeopardised.

As a final point, we would like to take this opportunity to reaffirm our commitment to the RCAP process, which provides us with the opportunity to benchmark ourselves against the global standards and our peers and further corroborates the robustness of EU legislation and the soundness of EU banks.

1 Assessment context

1.1 Regulatory system

The EU prudential framework for credit institutions³ is laid down in two pieces of (Level 1) legislation, namely a Regulation and a Directive, as enacted by the European Parliament and the Council and legally enforceable in all EU Member States. The Capital Requirements Regulation (CRR, Regulation (EU) No 575/2013) establishes a “single rule book” containing Pillar 1 and Pillar 3 requirements for the EU’s entire banking system and is directly applicable and binding in its entirety. This means that it applies directly, without having to be transposed into national law. The fourth Capital Requirements Directive (CRD IV)⁴ is legally binding and must be transposed into national law. It contains rules on authorisation, governance, risk management and buffer requirements. It also requires Member States to vest competent authorities with sufficient (Pillar 2) powers to address particular risks that are not well covered by the requirements contained in the CRR and to impose sanctions.

The CRR and the CRD IV are complemented or implemented by (Level 2) Binding Technical Standards (BTS) that are drafted by the EBA, based on mandates provided in the CRR and the CRD IV, and adopted by the EC. BTS are divided into Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS). RTS, which are adopted by means of delegated acts, supplement or amend certain non-essential elements of an EU legislative text (Regulation or Directive). ITS, which are adopted by means of implementing acts, aim at ensuring consistent implementation of legislative acts. BTS are legally binding and directly applicable in all Member States.

The EBA also issues (Level 3) Guidelines and Recommendations that elaborate on how requirements set by the EU law are to be applied by European regulators and supervisors. Although these Guidelines and Recommendations are not legally binding, supervisory authorities across the EU must make every effort to comply with them by incorporating them into supervisory practices as appropriate. Supervisory authorities are obliged to inform the EBA of their compliance or intention to comply with them and to also explain the reasons for any non-compliance (“comply or explain”). All non-compliance instances and the related reasons are placed in the public record.

The RCAP EU assessment relied upon the legal force of Directives, Regulations and BTS. It also took into account the Guidelines and Recommendations of the EBA to the extent that confirmations were received from the Member States that they comply with these Guidelines and Recommendations.

1.2 Status of implementation of the large exposures framework

Taking effect on 1 January 2014, the CRR introduced uniform rules concerning LEX requirements. The EU’s LEX requirements were amended to be more aligned with Basel LEX framework through the amendment to the CRR - Regulation (EU) 2019/876 (CRR II). The amendment was published on 7 June 2019 and the updated LEX requirements became applicable from 28 June 2021.

The LEX requirements provided in the CRR II were supplemented by a series of acts adopted by the EC and Guidelines issued by the EBA. These include:

- Commission Implementing Regulation (EU) 2021/451 of 17 December 2020, which set out the most updated detailed requirements with regard to LEX supervisory reporting. The amended

³ The same legislation also applies to systemic investment firms, which are required to be authorised as credit institutions.

⁴ Directive 2013/36/EU.

standards, which repealed Implementing Regulation (EU) No 680/2014 applied from 28 June 2021 and the first reporting reference date was 30 June 2021;

- Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014, which set out RTS for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets;
- RTS on the determination of indirect exposures to underlying clients of derivatives and credit default derivative contracts, which was delivered by the EBA in February 2021, has been adopted by the EC on 10 March 2022 and is currently in the scrutiny period before publication;
- EBA Guidelines on limits on exposures to shadow banking entities, issued on 14 December 2015;
- EBA Guidelines on connected clients, issued on 14 November 2017;
- EBA Guidelines on conditions for the application of the alternative treatment of institutions' exposures related to tri-party repurchase agreements, issued on 16 February 2021; and
- EBA Guidelines on large exposures breaches and time and measures to return to compliance, issued on 15 September 2021.

In the EU, the LEX framework applies to all credit institutions,⁵ on both an individual and consolidated basis, unless competent authorities do not apply supervision on an individual basis where they deem this appropriate.

1.3 Scope of the assessment

The Assessment Team considered the large exposure limits applicable to a sample of internationally active banks in the EU as of end-March 2022. The assessment had two dimensions:

- a comparison of EU regulations with the Basel LEX framework to ascertain that all the required provisions have been adopted (*completeness* of the regulations); and
- whether there are any differences in substance between the EU regulations and the Basel LEX framework and, if so, their significance (*consistency* of the regulations).

In its assessment, the Assessment Team considered all binding documents that effectively implement the Basel LEX framework in the EU. Annex 2 lists the Basel standards used as the basis for the assessment. The assessment did not evaluate the resilience of the banking system in the EU or the supervisory effectiveness of the EU authorities.

The Assessment Team evaluated the materiality and potential materiality of identified deviations between the Basel LEX framework and the EU regulations. The evaluation was made using a sample of 13 internationally active banks in the EU. Together, these banks comprise about 61% of the assets of internationally active banks in the EU. In addition, the Assessment Team reviewed the non-quantifiable impact of identified deviations and applied expert judgment as to whether the EU regulations meet the Basel LEX standards in letter and in spirit. The materiality assessment is summarised in Annex 3, which also lists the sample of banks.

The Assessment Team noted that, in one area, the EU regulations go beyond the minimum Basel standards. Although this element (listed in Annex 5) provides for a more rigorous implementation of the Basel framework, it has not been taken into account for the assessment of compliance.

⁵ Credit institutions also include "Class 1" investment firms that remain subject to the prudential framework (as set out in the Directive (EU) 2019/2034 and Regulation (EU) 2019/2033 on the prudential requirements of investment firms).

The outcome of the assessment is summarised using a four-grade scale, both at the level of each of the three key components of the Basel LEX framework and at the overall assessment of compliance. The four grades are compliant (C), largely compliant (LC), materially non-compliant (MNC) and non-compliant (NC).

2 Assessment findings

2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the LEX framework in the EU to be largely compliant with the Basel standard. This grade is based on the materiality assessment (summarised in Annex 3) and is driven by one potentially material finding and nine findings that were deemed not material.

Assessment grades		Table 1
Component of the Basel large exposures framework	Grade	
Overall grade	LC	
Scope and definitions	C	
Minimum requirements and transitional arrangements	LC	
Value of exposures	C	
Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).		

2.1.1 Scope and definitions

This component is assessed as compliant with the Basel standard.

Four findings deemed not material were identified: (i) exemptions of exposures to Deposit Guarantee Schemes (DGS); (ii) exemptions to interbank exposures to promote specific sectors of the economy; (iii) exemptions to regional governments or local authorities assigned a 20% risk weight under the standardised approach for credit risk; and (iv) temporary exemptions related to foreign exchange transactions, purchase or sale of securities, and money transmission.

2.1.2 Minimum requirements and transitional arrangements

This component is assessed as largely compliant with the Basel standard.

The Assessment Team identified one potentially material finding, which greatly contributed to the component grade as well as the overall grade. The finding relates to the EU's allowance for the LEX limit to be exceeded up to 600% of the institution's Tier 1 capital for the trading book exposures while the Basel LEX framework sets a 25% limit. If an EU bank does utilise the excess limit, it must report the breach to the national competent authorities and hold additional capital. Although all sample banks are not currently utilising the excess limit, the finding could become material if there were to be significant stress events either locally or globally that would prompt large institutions to utilise the excess limit. As such, this deviation is assessed as potentially material.

The Assessment Team observes that a significant part of the LEX framework came into effect on 28 June 2021 in the EU, over two years after the Basel Committee's agreed implementation date of January 2019.

2.1.3 Value of exposures

This component is assessed as compliant with the Basel standard.

Five findings deemed not material were identified: (i) the ability to reduce an exposure value by a portion of the value of the collateral that is eligible for credit risk mitigation (CRM) only under the Internal ratings-based (IRB) approach; (ii) the ability to use internally modelled haircuts for calculating the value of collateral; (iii) national discretion to allow for the exemption of substituted exposures in the form of collateral or a guarantee for residential loans or in the form of a guarantee for officially supported export credits; (iv) the exposure value of covered bonds eligible for preferential treatment; and (v) conditions to classify a covered bond as eligible for preferential treatment.

2.2 Detailed assessment findings

2.2.1 Scope and definitions

Section grade	Compliant
Basel paragraph number	13: Scope of counterparties and exemptions
Reference in the domestic regulation	Articles 400(1)(k), 400(2)(e) and 493(3)(e) of Consolidated text: Regulation (EU) No 575/2013 ⁶
Finding	<p>The Basel LEX framework exempts exposures to sovereigns and their central banks. This exemption also applies to public sector entities treated as sovereigns according to the risk-based capital framework.</p> <p>The EU regulations extend the list of exemptions to exposures to DGS. The EU authorities stated that DGS in Member States are public schemes backed by government guarantees. Therefore, this exemption falls under the category of special treatment for government exposures.</p> <p>The Assessment Team notes that the DGS are entirely funded by the bank and therefore did not consider the DGS as an exposure to sovereigns and their central banks. In the EU, institutions report the amounts exempted from the exposure value due to the application of Article 400. Data collected by the EBA show that banks included in the sample do not use the exemption; as such, the deviation is assessed as not material.</p>
Materiality	Not material
Basel paragraph number	13: Scope of counterparties and exemptions
Reference in the domestic regulation	Articles 400(2)(e) and 493(3)(e) of Consolidated text: Regulation (EU) No 575/2013
Finding	<p>The Basel LEX framework exempts exposures to sovereigns and their central banks. This exemption also applies to public sector entities treated as sovereigns according to the risk-based capital framework.</p> <p>The EU regulations extend the list of exemptions to interbank exposures to promote specific sectors of the economy. Specifically, asset items constituting claims on and other exposures to credit institutions incurred by credit institutions, one of which operates on a non-competitive basis and provides or guarantees loans under legislative programmes or its statutes, to promote specified sectors of the economy under some form of government oversight and restrictions on the use of the loans, provided that the respective exposures arise from such loans that are passed on to the beneficiaries via credit institutions or from the guarantees of these loans. Similarly, to DGS, the EU authorities stated that the possibility for competent authorities to exempt exposures in Articles 400(2)(e) and 493(3)(e) also falls under the category of special treatment for government exposures.</p>

⁶ "Consolidated text: Regulation (EU) No 575/2013" refers to Regulation (EU) No 575/2013 (CRR) as amended by Regulation (EU) 2019/876 (CRR II).

	Based on the data provided by the EBA, no sample banks are currently utilising the exemptions, as such the deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	13, 61: Scope of counterparties and exemptions
Reference in the domestic regulation	Articles 400(2)(b) and 493(3)(b) of Consolidated text: Regulation (EU) No 575/2013
Finding	<p>The Basel LEX framework exempts only exposures to sovereigns, their central banks, and public sector entities treated as sovereigns according to the risk-based capital framework.</p> <p>The EU regulations allow for competent authorities to fully or partially exempt asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 20% risk weight under the standardised approach for credit risk. The same applies to other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 20% risk weight.</p> <p>Depending on the exercise of this discretion by a Member State, a national rule may be less conservative than prescribed by the Basel LEX framework. The EU authorities stated that, in practice, the use of this discretion is not widespread across EU Member States. Regional governments and local authorities are treated as central governments in 10 Member States out of 27, of which only three are relevant for the RCAP exercise.</p> <p>The EU authorities also confirmed that none of the sample banks is currently holding large exposures to regional governments or local authorities in accordance with Article 400(2)(b). As a consequence, even in Member States where the exemption is established by national rules, such an exemption does not impact the current large exposures held by sample banks. Therefore, this finding is deemed not material.</p>
Materiality	Not material
Basel paragraph number	13, 65: Scope of counterparties and exemptions
Reference in the domestic regulation	Articles 390(6)(a), (b) and (c) of Consolidated text: Regulation (EU) No 575/2013
Finding	<p>The Basel LEX framework prescribes a special treatment for intraday interbank exposures to avoid disturbing the payment and settlement processes. Such exposures are exempted from the framework, either for reporting purposes or for application of the LEX limit.</p> <p>The EU regulations temporarily exempt from the limit exposures related to foreign exchange transactions, purchase or sale of securities, and money transmission, to avoid disturbing the payment and settlement processes. This temporary treatment encompasses all types of counterparty, not only interbank exposures, and the exempted period varies (following business day, two days or even five days), but in all cases it is longer than intraday.</p> <p>The EU authorities stated that, at the end of the exempted periods, institutions are required to report the remaining exposures arising from these transactions when they are greater than 10% of the Tier 1 capital. Moreover, institutions are prohibited from assuming new exposures that would lead to a breach of the LEX limit. The EU authorities also stated that the impact of these temporary exemptions is not material, given no breach in the LEX limit can be observed per supervisory reporting. Therefore, this deviation is deemed not material.</p> <p>For reference, as additional information, the Assessment Team notes that banks' risk management processes may result in establishing stricter internal limits for LEX that may apply even for some exposures exempted by the EU LEX framework. However, the establishment of such internal limits was not taken into consideration in the materiality assessment of this finding.</p>
Materiality	Not material

2.2.2 Minimum requirements and transitional arrangements

Section grade	Largely compliant
Basel paragraph number	16: Minimum requirement – the large exposure limit
Reference in the domestic regulation	Articles 395(1), 395(2), 395(5), 397 and 398 of Consolidated text: Regulation (EU) No 575/2013
Finding	<p>The Basel LEX framework requires that the sum of all the exposure values of a bank to a single counterparty or to a group of connected counterparties must not be higher than 25% of the bank's available eligible capital base at all times. This figure is set at 15% for the exposure of a global systemically important bank (G-SIB) to another G-SIB. The EU regulations allow the limits to be exceeded up to 600% of the institution's Tier 1 capital for the exposures on their trading book only. As per Article 395(5) of Regulation (EU) 2019/876, institutions must report without delay the information about this breach to the national competent authority. Additionally, when breaching the large exposure limits in the trading book, institutions are required to calculate additional own funds requirements as per Articles 397 and 398.</p> <p>The EU authorities stated that limits may be temporarily exceeded for the exposures on an institution's trading book under certain conditions and subject to capital charges, which depend on the amount of the excess. The provision is targeted specifically at certain types of investment firm that are currently still subject to the CRR (including the LEX regime) and are providing underwriting services. In addition, the flexibility is meant to address the issue with asset items in the trading book that are offset by liability items but not subject to Standardised Approach for Counterparty Credit Risk (SA-CCR)/netting. As an example, there are large holdings in share instruments, the value of which may fluctuate significantly but the fluctuation is "offset" by corresponding positions in trading book liabilities. The flexibility is meant to provide time for small institutions to cancel/reduce their trading book positions and is subject to punitive capital charges and the control of their competent authority.</p> <p>Given the flexibility in Article 395(5), institutions of any size may utilise the larger limit at any time. Despite institutions being required to cover the excess with own funds and to report the breach to the national competent authority, this is not consistent with the Basel LEX framework. There is no regulatory guarantee that these additional own funds would be sufficient to rapidly rectify the breach of the limit by returning the ratio to 25% or 15% for exposures to another G-SIB, as prescribed by the Basel LEX framework.</p> <p>The finding is not currently material, given that no banks in the sample are using the larger limit. However, the finding could become material if there is a significant stress event either locally or globally, which could cause exposures to individual counterparties to increase significantly and rapidly. The consequence of a potential impact in the future is that an internationally active bank (or a group of internationally active banks) could take advantage of such exemption to overcome temporary difficulties and might exceed the large exposure limit set forth in the Basel LEX framework. In such a case, a bank or even the financial system could be exposed to significant levels of concentration risk.</p> <p>The EU regulations do not rule out the option of this flexibility for internationally active banks, which could weaken the international level playing field across institutions, especially during stress conditions.</p> <p>Against this background, the finding is assessed as potentially material.</p>
Materiality	Potentially material

2.2.3 Value of exposures

Section grade	Compliant
Basel paragraph number	36–37 Eligible CRM techniques
Reference in the domestic regulation	Articles 399(1), (2), and (3) and 402 of Consolidated text: Regulation (EU) No 575/2013
Finding	<p>According to the Basel LEX framework, eligible credit risk mitigation techniques for LEX purposes are those that meet the minimum requirements and eligibility criteria for the recognition of unfunded credit protection and financial collateral that qualify as eligible financial collateral under the standardised approach for risk-based capital requirement purposes. Other forms of collateral that are eligible only under the IRB approach in accordance (receivables, commercial and residential real estate and other collateral) are not eligible to reduce exposure values for LEX purposes.</p> <p>The EU regulations allow, subject to a national discretion, institutions to reduce their exposure value by a portion of the value of the collateral that is eligible CRM only under the IRB approach. Specifically, residential and commercial real estate under certain conditions. The EU authorities stated that the provision is targeting small institutions with specialised business models (eg institutions that are active in commercial real estate sector lending). Further, the EU authorities stated that the rule came into effect prior to the adoption of the Basel LEX standard and its application did not raise material prudential concerns (ie given that the size of individual and connected mortgage exposures is relatively small, there is nothing to indicate that it leads to an undue concentration of exposures).</p> <p>Data provided by the EBA indicate that some sample banks utilise this CRM technique. However, the usage and impact are not material. The maximum impact across the sample banks was a reduction of 0.5432% in Tier 1 Capital. Additionally, the weighted average impact in Tier 1 capital reduction across all sample banks was 0.0079%.</p>
Materiality	Not material
Basel paragraph number	42: Recognition of CRM techniques in reduction of original exposure
Reference in the domestic regulation	Articles 399(1) and 401(2) of Consolidated text: Regulation (EU) No 575/2013
Finding	<p>The Basel LEX framework specifies that a bank must reduce the value of the exposure to the original counterparty by the amount of the eligible CRM technique recognised for risk-based capital requirements purposes. The recognised amount is the value of the collateral adjusted after applying the required haircuts, in the case of financial collateral when the bank applies the comprehensive approach. The haircuts used to reduce the collateral amount are the supervisory haircuts under the comprehensive approach. Internally modelled haircuts must not be used.</p> <p>The EU regulations for the Financial Collateral Comprehensive Method allow banks to utilise volatility adjustments either by using the Supervisory Volatility Adjustments Approach or the Own Estimates Approach. The EU authorities confirmed that banks may use own estimates for reducing the collateral amount.</p> <p>Data provided by the EBA indicate that nine out of 13 sample banks (70%) do not use own volatility estimates when reducing the collateral amount. Moreover, the EU authorities stated that using own volatility adjustments might not imply less prudent estimates, particularly in period of stress, as values are actually adjusted on current volatility information. Given these rationales provided by the EU authorities, the finding is assessed as not material.</p>
Materiality	Not material
Basel paragraph number	43: Recognition of exposures to CRM providers
Reference in the domestic regulation	Articles 400(2)(k) and (l) of Consolidated text: Regulation (EU) No 575/2013
Finding	The Basel LEX framework specifies that, whenever a bank is required to recognise a reduction of the exposure to the original counterparty due to an eligible CRM technique, it must also recognise an exposure to the CRM provider. The amount

	<p>assigned to the CRM provider is the amount by which the exposure to the original counterparty is reduced (except in the cases defined in paragraph 57 of the Basel LEX framework).</p> <p>The EU regulations allow for competent authorities to exempt substituted exposures in the form of a collateral or a guarantee for residential loans, under certain conditions. Additionally, the regulations allow for the exemption of substituted exposure in the form of a guarantee for officially supported export credits, under certain conditions. The EU authorities stated that both exemptions represent EU discretion and the SSM may grant the exemptions to the sample banks. Only a small number of Member States use the exemption for substituted exposures for officially supported export credits. Data provided by the EBA indicate that the sample banks are not currently utilising the exemptions. Therefore, the deviation is assessed as not material.</p>
Materiality	Not material
Basel paragraph number	69: Covered bonds
Reference in the domestic regulation	Articles 129(1), (3), and (6), 400(2)(a), and 493(3)(a) of Consolidated text: Regulation (EU) No 575/2013
Finding	<p>The Basel LEX framework requests that a covered bond satisfying all conditions set out in the framework (referred to in this report as "covered bond eligible for preferential treatment") may be assigned an exposure value of no less than 20% of the nominal value of the bank's covered bond holding. In practical terms, a covered bond eligible for preferential treatment may be exempted from the LEX limit by a maximum of 80% of its nominal value. Other covered bonds (non-eligible covered bonds) must be assigned an exposure value equal to 100% of the nominal value.</p> <p>As per the EU regulations, competent authorities in the EU may fully or partially exempt covered bonds eligible for preferential treatment (conditions for classifying a covered bond as eligible are prescribed in Article 129). The EU regulations do not define mandatory floors in the use of this exemption. Depending on the exercise of this discretion by a Member State, a national rule may be less conservative than the Basel LEX framework by exempting more than 80% of the nominal value of covered bonds eligible for preferential treatment.</p> <p>Within the Union, all Member States but one use this national discretion by exempting from the limit 80% of the nominal value, which is in line with the Basel LEX framework. One Member States utilises this national discretion by assigning an exposure value of 10% of the nominal value, which means that in practical terms 90% of the nominal value can be exempted, which is less conservative than prescribed by the Basel LEX framework. That said, the EU authorities stated that none of the concerned banks included in the RCAP sample holds such exposures in their portfolio and, therefore, this exemption is not used in practice.</p> <p>As such, this deviation is deemed not material.</p>
Materiality	Not material
Basel paragraph number	70: Covered bonds
Reference in the domestic regulation	<p>Article 129(1)(g) of Consolidated text: Regulation (EU) No 575/2013</p> <p>Article 1(d) of Regulation (EU) 2019/2160 (amendments to Article 129 of Consolidated text: Regulation (EU) No 575/2013)</p> <p>Article 14(2)(f) of Directive (EU) 2019/2162</p>
Finding	<p>The Basel LEX framework sets conditions to qualify a covered bond as eligible for preferential treatment, that is, the treatment of an assignment of no less than 20% of the nominal value of the bank's covered bond holding. Conditions must be observed together. Among other conditions, the following two apply:</p> <p>(1) The pool of underlying assets must exclusively consist of claims on, or guaranteed by, sovereigns, their central banks, public sector entities or multilateral development banks, as well as claims secured by mortgages on residential real estate or by commercial real estate with specific characteristics.</p>

	<p>(2) The nominal value of the pool of assets assigned to a covered bond instrument by its issuer should exceed its nominal outstanding value by at least 10% (referred to in this report as “overcollateralisation level of at least 10%”). If the national rule does not stipulate this requirement, the issuing bank needs to publicly disclose on a regular basis that their cover pool meets the 10% in practice.</p> <p>Regarding condition (1) mentioned above, as per Article 129(1)(g) of Consolidated text: Regulation (EU) No 575/2013, a covered bond in the EU collateralised by loans secured by maritime liens on ships up to the difference between 60% of the value of the pledged ship and the value of any prior maritime liens is eligible for preferential treatment. This type of collateral is not allowed in the pool of underlying assets prescribed by the Basel LEX framework.</p> <p>However, the EU authorities stated that these types of covered bond exist only in a few Member States, where there is a limited number of market players in this business line, and none of them is a bank included in the RCAP sample.</p> <p>Regarding condition (2) mentioned above, as per Article 1(d) of Regulation (EU) 2019/2160, which will enter into force from 8 July 2022, covered bonds with a minimum of 5% of overcollateralisation in the EU are eligible for the preferential treatment. Moreover, Member States may set a lower level of overcollateralisation, with a floor of 2%. These rules are less conservative than prescribed by the Basel LEX framework, which requires a level of at least 10% of overcollateralisation for covered bonds eligible for preferential treatment.</p> <p>Additionally, Article 14(2)(f) of Directive (EU) 2019/2162 requires institutions to provide to investors, at least on a quarterly basis, information on levels of statutory, contractual and voluntary overcollateralisation. However, such disclosure is generic and does not explicitly make a clear link between a covered bond to which the preferential treatment is applied in practice and its overcollateralisation level of at least 10%, as required by the Basel LEX framework.</p> <p>The EU authorities stated that there are no covered bonds compliant with Article 129 of Consolidated text: Regulation (EU) No 575/2013 with overcollateralisation below 10% within the top 20 exposures of sample banks.</p> <p>Therefore, this deviation is deemed not material.</p>
Materiality	Not material

2.3 Observations

The following observations highlight certain special features of the regulatory implementation of the Basel LEX framework in the EU. These are presented to provide additional context and information. Observations are considered compliant with the Basel LEX standards and do not have a bearing on the assessment outcome.

2.3.1 Minimum requirements and transitional arrangements

Basel paragraph number	93: Implementation date and transitional arrangements
Reference in the domestic regulation	Article 3 of Consolidated text: Regulation (EU) No 575/2013
Observation	<p>Paragraph 93 of the Basel LEX framework provides that all aspects of the LEX framework must be implemented in full by 1 January 2019.</p> <p>Regulation (EU) 2019/876, which implements a significant part of the Basel LEX framework, came into effect on 28 June 2021.</p>
Basel paragraph number	19–28: Definition of connected clients
Reference in the domestic regulation	<p>Article 4(1)(39) of Consolidated text: Regulation (EU) No 575/2013</p> <p>EBA Guidelines on connected clients</p>

Observation	The EU does not have legally binding documents that expound the definition of connected clients in Article 4(1)(39) of Regulation (EU) No 575/2013. However, EBA Guidelines on connected clients are in force and have a “comply or explain” status, with all EU competent authorities declaring compliance with the EBA Guidelines. The EBA is committed to submitting draft RTS to the EC by December 2022. The RTS will replace the current EBA Guidelines with a binding status.
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2.3.2 Value of exposures

Basel paragraph number	35: Definition of exposure value
Reference in the domestic regulation	Articles 400(1)(i), 400(2)(i) and 493(3)(i) of Consolidated text: Regulation (EU) No 575/2013
Observation	<p>For the purpose of calculating LEX, the Basel LEX framework requests that off-balance sheet items be converted into credit exposure equivalents through the use of credit conversion factors (CCFs) by applying the CCFs set out for the standardised approach for credit risk in the Basel capital framework, with a floor of 10%.</p> <p>The EU regulations fully exempt low-risk items that attract 0% CCF under the standardised approach for credit risk. The exemption is only applicable if an agreement has been concluded with the client or group of connected clients under which the facility may be drawn only if it has been ascertained that it will not cause the LEX limit to be exceeded. The EU treatment of low-risk items has the same expected result as the 10% CCF floor outlined in the Basel LEX standard.</p>
Basel paragraph number	43: Recognition of exposures to CRM providers
Reference in the domestic regulation	Articles 403(1) and (3) of Consolidated text: Regulation (EU) No 575/2013
Observation	<p>As stated in the Basel LEX framework, whenever a bank is required to recognise a reduction of the exposure to the original counterparty due to an eligible CRM technique, it must also recognise an exposure to the CRM provider. The amount assigned to the CRM provider is the amount by which the exposure to the original counterparty is reduced.</p> <p>In the case of tri-party repos, EU regulation provides an alternative treatment to ensure compliance with the LEX limit. Banks may instruct the tri-party agent upfront to apply certain limits on an ongoing basis for exposures to a collateral issuer. Rather than using the total amount of a banks’ exposure to a collateral issuer due to tri-party repo facilitated by a tri-party agent, the bank can use the full amount of the limits that it has instructed the tri-party to apply for a specific collateral issuer.</p> <p>The EU alternative treatment of tri-party repos ensures compliance with the LEX limit while limiting the operational burden of continuously monitoring and calculating the actual total exposure to the collateral issuer in tri-party repo.</p>
Basel paragraph number	65: Intraday interbank exposures
Reference in the domestic regulation	Articles 400(2)(f) and 493(3)(f) of Consolidated text: Regulation (EU) No 575/2013
Observation	<p>The Basel LEX framework exempts intraday interbank exposures from the LEX limit to avoid disturbing the payment and settlement processes.</p> <p>As per the EU regulations, competent authorities may fully or partially exempt asset items constituting claims on and other exposures to institutions, provided that those exposures do not constitute such institutions’ own funds, do not last longer than the following business day and are not denominated in a major trading currency. In practice, by national discretion, Member States can extend the definition of intraday to encompass the following business day.</p> <p>Supervisors in the EU exercise this national discretion. The EU authorities stated that the purpose of including the following business day in the definition of intraday interbank exposures is to accommodate time zone differences. Although this definition is not strictly the same as that prescribed by the Basel LEX framework, they are equivalent in</p>

	terms of expected results, that is, to avoid a disruption in the payment and settlement processes related to intraday interbank exposures.
Basel paragraph number	74: Collective investment undertakings, securitisation vehicles and other structures
Reference in the domestic regulation	Article 6(2)(b) of Regulation (EU) 1187/2014
Observation	<p>The Basel LEX framework requests that a bank must look through structures with underlying assets (funds or securitisations, for example) to identify those underlying assets for which the underlying exposure value is equal to or above 0.25% of the bank's Tier 1 capital. In this case, the counterparty corresponding to each of these underlying assets must be identified so that these exposures can be added to any other direct or indirect exposure to the same counterparty.</p> <p>As per Article 6(2)(b) of Regulation (EU) 1187/2014, the EU regulations allow for a special treatment, when the bank can ensure, by means of the structure's mandate, that the underlying exposures in the structure are not connected with any other exposures in the bank's portfolio, including underlying exposures from other structures. In this specific circumstance, the exposure shall be assigned to the structure as a separate client, not to the counterparty of each underlying asset that exceeds 0.25% of the bank's eligible capital base, as established by the Basel LEX framework.</p> <p>Although the EU regulations are not strictly the same as prescribed by the Basel LEX framework, they are equivalent in terms of expected results, given the regulatory condition in the use of the special treatment (that is, the absence of any other exposures in the bank's portfolio to the same counterparty).</p> <p>Even in a hypothetical circumstance where the exposure to an underlying asset in a structure is so high that it alone could significantly increase the bank's concentration risk, the EU regulations would be sufficient to capture this risk, not under the recognition of the underlying asset as a counterparty itself, but under the recognition of the structure as a separate client, to which the LEX limit would apply.</p>

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Mr Ben Gully	Office of the Superintendent of Financial Institutions, Canada
Mr Vasily Pozdyshev	Central Bank of Russia (until March 2020)

Assessment Team members

Ms Cristel Bakker	South African Reserve Bank
Ms Carolina dos Santos Barbosa	Central Bank of Brazil
Ms Kimberly Jameson	Office of the Comptroller of the Currency, United States
Mr Alexey Novikov	Central Bank of Russia (until February 2022)
Ms Soojung Park	Financial Supervisory Service, Korea (until March 2020)
Ms Joy Wann	Basel Committee Secretariat (until March 2020)

Supporting members

Ms Catherine Girouard	Office of the Superintendent of Financial Institutions, Canada
Ms Yuka Kanai	Basel Committee Secretariat
Ms Bingzhe Zhao	Basel Committee Secretariat
Mr Masaya Hatoma	Basel Committee Secretariat (until March 2020)
Mr Olivier Prato	Basel Committee Secretariat

Review Team members

Mr Andrew Tan	Monetary Authority of Singapore
Mr Jorge Luis Garcia Ramirez	Bank of Mexico
Mr Toshio Tsuiki	Basel Committee Secretariat

Annex 2: List of Basel standards and implementing regulations issued by the EU authorities

The following Basel standards were used as the basis of this RCAP assessment:

- *Supervisory framework for measuring and controlling large exposures, September 2016*
- *Frequently asked questions on the supervisory framework for measuring and controlling large exposures, September 2016*

Table A.1 lists the regulations issued by the EU authorities to implement the LEX framework in the EU. Previous RCAP assessments of the EU's implementation of the Basel standards considered the binding nature of regulatory documents in the EU.⁷ This RCAP Assessment Team did not repeat that assessment, but instead relied on the previous assessments' findings. Those assessments concluded that the types of instrument described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

Overview of relevant large exposure regulations in the EU		Table A.1
Domestic regulations	Type, version and date	
Consolidated text: 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.	Level 1 Regulation. The latest version of Regulation (EU) No 575/2013, amended by Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019, came into effect from 28 June 2021.	
Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014.	Level 2 implementing act, laying down the reporting requirements, in force from 28 June 2021.	
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.	Level 2 delegated act, issued on 2 October 2014, in force from 23 October 2014.	
Regulation (EU) 2016/445 of the European Central Bank of 14 March 2016 on the exercise of options and discretions available in Union law.	Level 1 Regulation, in force from 1 October 2016.	
Regulatory technical standards on determining indirect derivatives exposures within the large exposures framework.	Level 2 delegated act, adopted on 10 March 2022, currently under scrutiny by EU Parliament and Council.	
Source: EU authorities.		

⁷ See Annex 6 of the RCAP assessment of the Basel III LCR regulations in the EU, www.bis.org/bcbs/publ/d410.pdf

Annex 3: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings described in Section 2.2 and summarised in Table A.2. Assessment Teams evaluate the materiality of findings quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the cumulative impact of the identified deviations on the reported LEX of banks in the RCAP sample. These banks are listed in Table A.3.

Number of deviations by component			Table A.2
Component	Not material	Potentially material	Material
Scope and definitions	4	0	0
Minimum requirements and transitional arrangements	0	1	0
Value of exposures	5	0	0

RCAP sample banks		Table A.3
Banking group	Share of banks' assets in the total assets of internationally active banks in the EU (per cent)	
BNP Paribas	10.9	
Crédit Agricole	7.7	
BPCE	5.2	
Société Générale	5.4	
Commerzbank	2.5	
Deutsche Bank	4.7	
UniCredit	4.1	
Intesa Sanpaolo	3.5	
ING	4.1	
Rabobank	2.4	
Santander	6.7	
BBVA	2.9	
SEB	1.5	
TOTAL	61.4	

Source: EU authorities. For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

Annex 4: Issues for follow-up RCAP assessments

The Assessment Team identified the following issues for future RCAP assessments for the EU:

- With respect to the finding regarding the ability to use internally modelled haircuts for calculating the value of collateral, the EU authorities stated that the EC has proposed an amendment to the current provisions on the *possibility* of using own volatility estimates via the deletion of the corresponding provisions in the CRR. (COM (2021) 664 final Page 125 for Article 223(6) and page 128 for Article 225).

Annex 5: Areas where the EU rules are stricter than the Basel standards

In the following area, EU authorities have adopted a stricter approach than the minimum standards prescribed by the Basel Committee. This is listed below for information. The stricter rule has not been taken into account as mitigants for the overall or for the component-level assessment of compliance.

- The EU Regulations do not allow the automatic application of CCF to calculate the exposure value of off-balance sheet items, as outlined in the paragraph 35 of the Basel LEX framework. Rather, the default treatment of off-balance sheet items is by default 100%. Competent authorities have the discretion to exempt certain off-balance sheet items. The exemptions which are permitted in 400(2)(i) of Consolidated text: Regulation (EU) No 575/2013 include 50% of medium/low-risk off-balance sheet documentary credits referred to in Annex I of the regulation; 50% of medium/low-risk off-balance sheet undrawn credit facilities referred to in Annex I of the regulation; and 80% of guarantees other than loan guarantees that have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institutions. Compared with the Basel LEX requirements, these items are subject to a more conservative treatment under the EU regulation.