CRR/CRD: The delegated act on Market Risk under CRR and other forthcoming delegated acts in banking

Committee on Economic and Monetary Affairs
Scrutiny Session of 17 February 2020

This briefing has been prepared to support ECON’s work on scrutiny of delegated acts, in particular the discussion of 17 February 2020 on one adopted and two forthcoming draft measures (Delegated Acts (DAs)), i.e. Regulatory Technical Standards (RTS) under the Capital Requirements Directive 2013/36/EU (CRD) and the Capital Requirements Regulation (EU) No 575/2013 (CRR). This first ECON scrutiny session continues the ECON’s discussions on CRD/CRR during the previous legislature and covers in particular the delegated act on market risk (C(2019) 9068). In addition, two forthcoming RTS are discussed: the RTS on mapping of derivative transactions for which the EBA has finalised its draft, and the RTS on criteria to define managerial responsibility and control functions on which the EBA has started a consultation.

In brief

The CRD and CRR constitute the core of European banking legislation. They contain many empowerments for the Commission to adopt ‘Level 2’ measures, i.e. delegated acts (DAs)\(^1\), including specific types thereof, namely regulatory technical standards (RTS) which are based on drafts by the European Banking Authority (EBA).\(^2\) DAs are crucial for the application of the CRR/CRD and for the industry in view of their substantive impact on e.g. calculation methods for capital requirements. In view of the prerogative of the European Parliament to object to DAs, this briefing focusses on the delegated act on market risk under Article 461a CRR (C(2019) 9068) adopted by the Commission on 17 December 2019. By adopting this DA, the Commission changes the Level 1 text of the CRR (while most DAs ‘supplement’ the Level 1 legal basis). In addition, the EBA’s final draft RTS on mapping of derivative transactions to risk categories and the EBA consultation paper on the RTS on managerial responsibility and control functions are discussed.

ITEMS FOR DISCUSSION


Background: Basel Standard - Following a fundamental review of the trading book (FRTB) by the Basel Committee on Banking Supervision (BCBS) which significantly changed the approaches to be used by banks for the calculation of capital requirements for market risk, a new framework for market risk was

\(^1\) Under Articles 290 of the Treaty on the Functioning of the EU (TFEU).

\(^2\) See the overviews on EUR-lex: [CRD IV ITS](https://eur-lex.europa.eu/eli/legis/dec/nl/2018/1849) and [CRD IV RTS](https://eur-lex.europa.eu/eli/legis/dec/nl/2018/1849), as well as CRR ITS and CRR RTS listing all acts adopted and published.

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published by the BCBS in January 2016.\(^3\) To adjust the calibrations of these approaches, the BCBS carried out a second review which was finalised in January 2019.\(^4\)

**Standardised approach (SA)**

The SA comprises three main blocks: the sensitivities-based method (SBM), the default risk charge (DRC) and the residual risk add-on (RRAO). Each block covers specific types of risk that are relevant in the context of market risk. A risk charge is computed for each of the three blocks, the sum of which is the overall risk charge for market risk under the SA. No diversification benefits are allowed across the three blocks.

**EU Implementation** - The implementation of the FRTB into the EU financial service acquis has been done in a first step by means of a reporting requirement in CRR (CRR2 amendment), which does not yet trigger own funds/capital requirements. Due to the timing of the latest ‘Basel’ changes to the standardised approach (SA), they could not be incorporated in the banking package before its adoption in May 2019. Therefore, the Commission was empowered to introduce them later by means of a DA. According to Article 430b of Regulation (EU) 2019/876 (amending CRR) this specific reporting requirement for market risk shall be applicable from the date of application of the DA referred to in Article 461a CRR. This latter Article lists all the Articles which might be amended by the DA.

**Scope** - The adoption of this DA by the Commission on 17 December 2019, which contains the elements necessary to make the reporting requirement operational (i.e. it clarifies how institutions need to carry out the calculations the results of which need to be reported), will represent the second step in the

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\(^3\) BCBS 2016, see [http://www.bis.org/bcbs/publ/d352.pdf](http://www.bis.org/bcbs/publ/d352.pdf).
implementation process. It covers the sensitivities-based method (SBM) of the alternative standardised approach; however, the default risk charge and the residual risk add-on are outside the scope of the DA. However, the Commission noted in the explanatory memorandum to the DA that ‘one new element related to the alternative standardised approach coming from the final FRTB framework, namely the introduction of new correlation values for credit risk factors mapped to the new credit index bucket, could not be introduced since the corresponding provision is set out in Article 325ai of Regulation (EU) No 575/2013 which is not covered by the empowerment and therefore cannot be amended.’

**Timing** - While the Commission summarised in the DA register: ‘As part of the political agreement on the banking package amending Regulation (EU) No 575/2013, the EU co-legislators agreed that all institutions with large trading activities established in the Union should report the results of the new standardised approach for market risk, finalised by the Basel Committee in January 2019, no later than December 2020. The Commission is empowered to make this approach fully operational via a delegated act.’, the EBA summarises in its consultation paper7: ‘Considering all relevant factors, as well as the benefits of a fixed application date, the first applicable reference date for the reporting in accordance with Article 430b CRR, is envisaged to be the 31 March 2021.’ In addition, the EBA has also provided more details in its Roadmap for the new market and counterparty credit risk approaches of 27 June 2019.

**ECON priority** - This DA on market risk was earmarked as a priority for ECON because - different from the many DAs that ‘supplement’ the level 1 text - this DA changes, or rather re-writes - the wording of the CRR, i.e. the text as agreed by the co-legislators. In addition, the FRTB rules for capital requirements for market risk require banks to review their methods for calculating market risk measures. While this DA ‘only’ introduces a reporting requirement, the future will show the exact impact but the capital charges are likely to increase for many banks - based on BIS’ estimates during the interim impact analysis phase,8 and also according to the EBA’s impact assessment of the FRTB.9

**Next steps** - Article 519b CRR on Own fund requirements for market risk stipulates that by 30 June 2020 the Commission shall - as a third step and based on an EBA report - submit a report and a legislative proposal on how to implement an adequate own funds requirements for market risk.

**Procedure:** Under Article 290 TFEU, the Parliament may object to the above mentioned delegated act, but cannot amend it. The Commission has informed Parliament that the deadline for objections by Parliament and Council is three months from the date of notification, i.e. until 18 March 2020. In accordance with Article 462(6) CRR, the scrutiny deadline may be extended once by another three months. If the ECON Committee considers it appropriate, it may table a reasoned motion for a resolution to plenary objecting to the delegated act within the scrutiny period, stating the reasons for Parliament’s objections to the above-mentioned delegated act and possibly incorporating a request to the Commission to submit a new delegated act taking into account Parliament’s recommendations (Rule 111(3) of the Rules of Procedure).

**State of play:** The DA, as adopted by the Commission, is currently under scrutiny by the European Parliament and the Council.10

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6 For more background and comments on the EU implementation if Basel see e.g. Deloitte, Implementing the FRTB in the EU, 6 December 2018, https://blogs.deloitte.co.uk/financialservices/2018/12/implementing-the-frtb-in-the-european-union.-html
8 Estimation was that the capital requirements for banks are expected to increase by 41% on an average, with the median bank’s increase expected to be somewhere around 18% see Fundamental review of the trading book – interim impact analysis, Bank for International Settlements, November 2015, http://www.bis.org/bcbs/publ/d346.htm
9 The EBA updated end 2019 its (2018) impact assessment on the FRTB implementation, which overall will mean a weighted average increase of 2.2% in Tier 1 minimum required capital (and a10% relative to current levels of required capital for market risk only) for a sample of 189 banks from 19 EU countries see https://eba.europa.eu/eba-updates-estimates-impact-implementation-
baseliii-and-provides-assessment-its-effect-eu-economy
10 To be noted that the European Banking Authority (EBA) has published a Consultation Paper - Draft Implementing Technical Standards on specific supervisory reporting requirements for market risk, EBA/CP/2019/13 of 21 November 2019 under Article 430b(6) of Regulation (EU) No 575/2013 (CRR). This consultation concerns the draft implementing technical standards (ITS) on
2. EBA Final draft Regulatory Technical Standards on mapping of derivative transactions to risk categories, on supervisory delta formula for interest rate options and on determination of long or short positions in the Standardised Approach for Counterparty Credit Risk under Article 277(5) and Article 279a(3)(a) and (b), respectively, of Regulation (EU) No 575/2013 (revised Capital Requirements Regulation – CRR2)

**Background:** The European Banking Authority (EBA) has published its EBA Final draft Regulatory Technical Standards on mapping of derivative transactions to risk categories, on supervisory delta formula for interest rate options and on determination of long or short positions in the Standardised Approach for Counterparty Credit Risk under Article 277(5) and Article 279a(3)(a) and (b), respectively, of Regulation (EU) No 575/2013 (revised Capital Requirements Regulation – CRR2), [EBA-RTS-2019-02](https://eba.europa.eu/eba-publishes-final-draft-standards-key-aspects-related-implementation-standardised-approach) on 18 December 2019.\(^{11}\) This final draft regulatory technical standards (RTS) specifies the key aspects of the **standardised approach to counterparty credit risk** (SA-CCR). The amendments to the revised Capital Requirements Regulation (CRR2) implement in EU legislation, amongst other things, this revised SA-CCR. The EBA developed its draft RTS based on the - at that time proposed - legislative text of CRR2 and where relevant, has adapted it to the final CRR2 text.

The RTS set out the method for identifying the **material risk drivers** of derivative transactions on the basis of which the mapping to one or more of the risk categories is to be done. Additionally, the RTS set out the formula that institutions will have to use to calculate the supervisory delta of options, when mapped to the interest rate risk category, which is compatible with negative interest rates and also introduce a method suitable for determining the direction of the position (long or short) in a material risk driver\(^ {12}\) of each derivative transaction.

The DA that will result from this draft RTS is earmarked by the ECON Committee as a **priority** DA because this act is linked to the DA on market risk as described above and to the implementation of the FRTB; hence its importance to the market participants concerned.

**Procedure:** The Commission has, in accordance with Article 10 Regulation (EU) No 1093/2010 (EBA Regulation), three months to decide whether to endorse the draft RTS as proposed, or to adopt them with modifications, e.g. adoption in part only, or with amendments, where the Union’s interests so require, having regard to the specific procedure laid down in those Articles.

**State of play:** The Commission is currently working on the act to be adopted.

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\(^{12}\) That means a risk driver identified as material pursuant to the methodology of the RTS. Once the risk driver of a derivative transaction has been identified as material, it needs to be specified whether the transaction is long or short in that risk driver, in order to assign a delta parameter (e.g. +1 or -1). To be noted that the mandate is restricted in scope to cover only risk drivers that are ‘material’.
3. **EBA Consultation Paper - Draft Regulatory Technical Standards on the criteria to define managerial responsibility and control functions, material business unit and significant impact on their risk profile, and other categories of staff whose professional activities have an material impact on the institutions’ risk profile**

**Background:** The EBA launched the *Consultation Paper - Draft Regulatory Technical Standards on the criteria to define managerial responsibility and control functions, material business unit and significant impact on their risk profile, and other categories of staff whose professional activities have an material impact on the institutions’ risk profile*, EBA/CP/2019/16 on 19 December 2019 under Article 94 (2) CRD (Capital Requirements Directive 2013/36/EU). These Regulatory Technical Standards (RTS) on the criteria to identify all categories of staff whose professional activities have a material impact on the institutions’ risk profile (so called ‘risk takers’). The aim of these standards is to define and harmonise the criteria for the identification of such staff and to ensure a consistent approach across the EU. The suggested identification process is based on a combination of qualitative and quantitative criteria. The EBA is mandated to develop draft RTS to set out criteria to define

- managerial responsibility and control functions,
- material business unit and significant impact on the relevant business unit’s risk profile, and
- other categories of staff not expressly referred to in Article 92(3) CRD whose professional activities have an impact on the institution’s risk profile comparably as material as that of those categories of staff referred to therein.

The revised RTS takes also into account the supervisory experience gained since the entry into force in 2014 of the *Regulation (EU) No 604/2014* (RTS on identified staff) and of the results of the EBA’s peer review on identified staff.

![Figure 1: Overview on the identification outcome](image)

**Source:** EBA Consultation Paper EBA/CP/2019/16, p. 28

The ECON Committee identified these forthcoming RTS as a **priority** because - learning the lessons of the last crisis - the purpose of the requirements applied to remuneration rules is to promote sound and

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effective risk management of banks by aligning both, the interests of banks/shareholders and their staff as far as this staff’s activities have a material impact on the bank’s risk profile.\textsuperscript{15}

**Procedure:** Once the consultation period ends, the EBA will analyse the feedback and proceed to produce a report containing a draft text of the RTS. After the finalisation of the draft RTS, it is planned to submit it in June 2020 to the European Commission for adoption.

**State of play:** The consultation will end on 19 February 2020.

### SOME GENERAL ITEMS FOR DISCUSSION

**Background:** The EBA publishes all final draft RTS and ITS on its website as soon as they are submitted to the Commission. In accordance with Article 10(1) EBA Regulation, the Commission has three months to decide on whether to endorse a draft RTS as proposed or in part only, or with amendments, where the Union’s interests so require, observing the specific procedure laid down in this Article. As part of the informal cooperation established between ECON and the Commission on draft level 2 measures, ECON Members may submit comments and questions on the EBA’s drafts to the Commission services.

\(\Rightarrow\) However, it often takes the Commission (much) more than three months to reach the adoption of RTS as DAs, see next heading on ‘state of play’.

- **Recent changes introduced by the ESAs review:**
  - **a) Forwarding draft RTS to EP:** Previously, the Commission had the obligation to forward the draft RTS received from the EBA immediately to the Parliament; Article 10(1) fourth subparagraph EBA Regulation (EU) No 1093/2010. However, delays occurred in the submission.

  \(\Rightarrow\) This issue was addressed in the recent amendment to the EBA Regulation (Regulation (EU) 2019/876 - no consolidated version available yet). Since 2020, the EBA now forwards its drafts simultaneously to the Commission, the European Parliament and the Council.

  - **b) Deletion of shortened 1 month scrutiny period:** Following the adoption of the amendments to the Regulations for the European Supervisory Authorities (EBA, EIOPA, ESMA), the possibility of a shortened scrutiny period of only one month if the Regulatory Technical Standard (RTS) adopted by the Commission is ‘the same’ as the text provided by the ESA (previous Article 13 in the ESAs regulations) has now been deleted. This means that if the scrutiny period is determined by one of the ESAs regulations, it is always three months (and can be extended by another three months).

- **Transparency & legal issues:** Delivery dates are set by the co-legislators. The EBA wrote letters to the Commission in 2015 and in 2016 to request revised deadlines for delivery of certain draft RTS under CRR/CRD; a new letter (not yet published on the EBA’s website) requesting revised deadlines for RTS in CRD/CRR and BRRD was sent in December 2019. The requests may be seen as related to Art. 10(2) EBA Regulation (‘Where the Authority has not submitted a draft RTS within the time limit set out in the legislative acts referred to in Article 1(2), the Commission may request such a draft within a new time limit.’)

  \(\Rightarrow\) The EBA’s prolongation request letters are usually available on the EBA website, but the Commission’s decision on the prolongation of deadlines is not made public or notified to the Parliament.

  Certain RTS have been put ‘on hold’ in the past by the EBA; e.g. the one on Mortgage Lending Value, Art. 124(4) CRR (initial deadline 31.12.2014); for others, the EBA will monitor (RTS under Art. 183(6) and Art. 221(9) CRR) or proposes deletion (RTS under Art. 194(10) CRR), see EBA Report on Credit Risk Mitigation (CRM) framework of 19 March 2018.

  \(\Rightarrow\) While the EBA explains in various reports and opinions the reasons for such non-delivery of draft RTS, an overview in a single document is not available but would be useful (Commission to extend its overview/EBA to supplement its interactive single rulebook on CRD/CRR?)

CURRENT STATE OF PLAY

- The Commission has already adopted and published many DAs and IAs under the CRD and the CRR including RTS, ITS and amending acts, see the published overviews on EUR-lex (see footnote 2).
- According to the latest Commission overview (of 28 June 2019) on RTS under CRR and CRD, 36 RTS have already been adopted; still pending or put on hold/suspended are 16 RTS\(^\text{16}\).

For seven of these RTS under CRR and CRD, final EBA drafts are available - even if according to Art. 10 of Regulation (EU) No 1093/2010 (EBA Regulation), the Commission has to react within three months.

Table 1: Overview on pending EBA draft RTS (without reviews, prolongation of waivers, etc.)

<table>
<thead>
<tr>
<th>RTS subject and legal basis (bold: files of specific interest for ECON)</th>
<th>Submission deadline CRR/CRD IV</th>
<th>EBA draft RTS delivered on</th>
<th>COM planning/OJ publication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market risk assessment methodology (internal models and significant share), Art 363(4)(b) and (c) CRR</td>
<td>31.12.2014</td>
<td>22.11.2016</td>
<td>was 2016, then 5/2018, now Q2/2020</td>
</tr>
<tr>
<td>Authorisation of credit institutions*, Art 8(2) CRD</td>
<td>31.12.2015/16</td>
<td>14.7.2017</td>
<td>was 31.12.2016, then 5/2018, now Q2/2020</td>
</tr>
<tr>
<td>Economic downturn loss given default (LGD) and conversion factors, Art 181(3), 182(4)(a) CRR see EBA opinion 4.2.2016</td>
<td>31.12.2014</td>
<td>16.11.2018</td>
<td>was Q4/2019, now Q2 2020</td>
</tr>
<tr>
<td>Calculation of KIRB, Art. 255(9) CRR</td>
<td>9.4.2019</td>
<td>4.4.2019</td>
<td>was Q4/2019, now Q2/2020</td>
</tr>
<tr>
<td>Eligible collateral within CRM framework*, Art 194(10) CRR</td>
<td>30.6.2014</td>
<td>EBA prop. deletion**</td>
<td>suspended</td>
</tr>
<tr>
<td>Risk weights mortgage lending, Art 164(6), 124(4)(b) CRR</td>
<td>31.12.2014</td>
<td>see EBA letter 5.9.16</td>
<td>was 30.6.2016,</td>
</tr>
</tbody>
</table>

**Bold** = priority files for ECON, * = extension requested; italics = new change to table of 2/2012. ** On the first two RTS, the EBA will be continuously monitoring the need to deliver on these mandates also in light of international developments in this regulatory area on the third RTS mandate, EBA recommends this be deleted from CRD, see EBA Report on Credit Risk Mitigation (CRM) framework of 19 March 2018; blue background: no draft RTS delivered yet by the EBA

Previous CRD/CRR state of play briefings are available: see the briefing provided for the CRD/CRR session of 28.2.2017, the briefing provided for the session of 26 March 2018, and the briefing provided for the session of 18 June 2018.

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\(^{16}\) The Commission’s DG FISMA website provides regularly updated overview lists on RTS, and on ITS supplementing CRR/CRD (last RTS update 28 June 2019), listing the adopted and outstanding measures.
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