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COMMISSION DELEGATED REGULATION (EU) .../...

of 14.12.2020

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assigning risk weights to specialised lending exposures

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 153(9) of Regulation (EU) No 575/2013 ('the Regulation') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Articles 10 to 14 of Regulation No (EU) 1093/2010, delegated acts specifying the assignment of risk weights to specialised lending exposures.

In accordance with Article 10(1) of Regulation No (EU) 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 153(9) of Regulation (EU) No 575/2013 ('the Regulation'). A consultation paper was published on the EBA internet site on 11 May 2015, and the consultation closed on 11 August 2016. Moreover, the EBA invited the EBA's Banking Stakeholder Group set up in accordance with Article 37 of Regulation No (EU) 1093/2010 to provide advice on them. Together with the draft technical standards, the EBA has submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has submitted its Impact Assessment, including its analysis of the costs and benefits, related to the draft technical standards submitted to the Commission. This analysis is available at <https://www.eba.europa.eu/regulation-and-policy/credit-risk/regulatory-technical-standards-on-specialised-lending-exposures>, pages 29-36 of the Final Draft Regulatory Technical Standards package.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

These draft 'regulatory technical standards' ('RTS') specify how institutions should take into account the factors of financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, and security package when assigning risk weights to specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet the requirements set out in Section 6 of Chapter 3 of Title II of Part Three of Regulation (EU) No 575/2013. Those factors are further specified in the form of sub-factors, which provide further clarification about the assessment criteria for each of them, and for some sub-factors, these sub-factors are further specified in sub-factor components. These draft RTS specify how institutions should assign each specialised lending exposure to one of the categories listed in Table 1 of Article 153(5) of Regulation (EU) No 575/2013.

Institutions are required to classify each specialised lending exposure in one of the four specified classes, project finance, real estate, object finance and commodities finance. For specialised lending exposures that are not in default, institutions should apply the assessment

criteria associated with the relevant class in the Annexes of these RTS. For specialised lending exposures that are identified as in default, the institution should assign the exposure to category 5.

In addition to this, in exceptional situations, the institutions should be allowed not to apply a certain sub-factor or sub factor component for an individual specialised lending exposure, where they find it not to be relevant. Institutions should also be allowed not to apply a certain sub-factor or sub-factor component to all specialised lending exposures belonging to a type of exposures when that sub-factor or sub-factor component is not a relevant risk driver for that type of specialized lending exposures.

Institutions should specify for each type of exposure how the different factors are combined in the final assignment of the specialised lending exposure to one of the categories. The final assignment to a category should be done on the basis of the weighted average of the cardinal numbers of the categories to which the exposure has been assigned, for each factor. The weight that institutions assign to each factor should not be lower than 5% and not be higher than 60%.

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(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 648/2012¹, and in particular the third subparagraph of Article 153(9) thereof,

Whereas:

- (1) Under the Internal Ratings Based Approach ('IRB Approach'), for specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet certain requirements, institutions are to assign risk weights to specialised lending exposures in accordance with Article 153(5) of Regulation (EU) No 575/2013 by attributing them to one of the categories in Table 1 set out in the first subparagraph of Article 153(5) based on their assessment of the specialised lending exposure against each of the factors referred to in its second subparagraph. In order to ensure a harmonised approach to the assignment of the specialised lending exposures to categories, it should be laid down how those factors are to be taken into account by providing for a calculation of values on the basis of which the factors can be linked to the risk categories of that Table. As the specialised lending exposures belong to the corporate exposure class within the IRB Approach and as the method for assigning risk weights to such exposures specified in Article 153(5) of Regulation (EU) No 575/2013 is a form of rating system, the regulatory technical standards for assigning risk weights to specialised lending exposures set by this Regulation should apply in addition to the general rules concerning the assignment of risk weights to corporate exposures and other requirements with regard to rating systems under the IRB Approach.
- (2) In order for the institutions to adequately apply each of those factors, they should be further specified in the form of sub-factors with a view to clarifying the assessment criteria for each situation. In order to adequately assess the sub-factors, it is necessary to further specify some sub-factors in sub-factor components.
- (3) In order to reflect the internationally agreed standards on assigning risk weights to specialised lending exposures, as specified by the Basel Committee on Banking

¹ OJ L 176, 27.6.2013, p. 1.

Supervision in the Basel II framework², and to take into account the large number of variations in specialised lending exposures, different assessment criteria should be applied to each of those classes of specialised lending exposures when applying the factors. Before assigning a risk weight to a specialised lending exposure, institutions should determine to which of those classes the specialised lending exposure most closely corresponds.

- (4) Where an obligor is in default, institutions should assign the risk weight category 5 in Table 1 of Article 153(5) of Regulation (EU) No 575/2013 and the highest expected loss category, i.e. category 5 in Table 2 of Article 158(6) of that Regulation, to the specialised lending exposure in line with the Basel II framework.
- (5) The attribution by the institutions of a category to each factor should be done on the basis of an overall assessment taking into consideration the categories attributed to the sub-factors of the factor as well as the relative importance which each sub-factor has for the type of specialised lending exposure. The same procedure should be followed when attributing a category to sub-factors where a sub-factor is further specified in sub-factor components.
- (6) In order to achieve the greatest possible accuracy and consistency in the assignment of specialised lending exposures to categories, the institutions should attribute a weight to each factor having regard to its relative importance for the type of specialised lending exposures and determine the weighted average of the values of the categories which have been attributed to the factors. In order to ensure that the institutions assign these weights in a sufficiently prudent way, a lower and an upper limit should be set for the weight that can be assigned to each factor.
- (7) Under Regulation (EU) No 575/2013 institutions are required to document the assignment of risk weights under the IRB Approach in general. In order to facilitate the verification by the competent authorities of the correct application of the rules on the assignment of risk weights to specialised lending exposures as referred to in the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013, certain specific documentation requirements should be laid down for the assignment of risk weights to those exposures.
- (8) This Regulation is largely based on the internationally agreed standards on assigning risk weights to specialised lending exposures. Given the variety of specialised lending exposures and given the specificities of such exposures, it may not capture all risk drivers which institutions identify in their daily business, either for particular types of exposures within the meaning of point 2 of Article 142(1) of Regulation (EU) No 575/2013 or for individual specialised lending exposures. Given that the institutions are required by Article 171(2) of Regulation (EU) No 575/2013 to take into account all relevant information for assignment of obligors and facilities to grades or pools, the institutions should be required to take into account each of any additional risk drivers and consider it jointly with the sub-factor of the specialised lending exposure framework which most closely corresponds to the risk driver. Where this is done for an individual specialised lending exposure, it should be considered an override for the purposes of Article 172(3) of Regulation (EU) No 575/2013. The institution should document why it was appropriate to take into account additional risk drivers and provide a justification for it.

² International Convergence of Capital Measurement and Capital Standards, A Revised Framework, Comprehensive Version, June 2006.

- (9) The provisions on the application of overrides in the IRB Approach also apply to specialised lending exposures. Therefore, the institutions are allowed, exceptionally, not to apply a certain sub-factor or sub-factor component, for an individual specialised lending exposure, where they find it not to be relevant. Institutions should also be allowed, exceptionally, not to apply a certain sub-factor or sub-factor component for all specialised lending exposures belonging to a type of exposures as defined in point (2) of Article 142(1) of Regulation (EU) No 575/2013 when that sub-factor or sub-factor component is not a relevant risk driver for that type of specialised lending exposures. The institutions should be required to document the decision not to apply a sub-factor or a sub-factor component and to provide a justification for it.
- (10) The institutions should be allowed a sufficient period of time to adapt their rating systems for assigning risk weights to specialised lending exposures in order to comply with the rules laid down in this Regulation.
- (11) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Banking Authority.
- (12) The European Banking Authority 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 advice of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council³,

HAS ADOPTED THIS REGULATION:

Article 1

Applicable assessment criteria for different classes of specialised lending exposures

1. Where the purpose of a specialised lending exposure is to finance the development or acquisition of large, complex and expensive installations, including in particular power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure, and the income to be generated by the assets is the money generated by the contracts for the output of the installation obtained from one or several parties which are not under management control of the sponsor ('project finance exposures'), institutions shall apply the assessment criteria set out in Annex I to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013.
2. Where the purpose of a specialised lending exposure is to finance the development or acquisition of real estate, including in particular office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, hotels and land, and the income to be generated by the real estate is lease or rental payments or the proceeds from the sale of such real estate obtained from one or several third parties ('real estate exposures'), institutions shall apply the assessment criteria set out in Annex II to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013.
3. Where the purpose of a specialised lending exposure is to finance the acquisition of physical assets, including in particular ships, aircraft, satellites, railcars, and fleets,

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).

and the income to be generated by those assets is lease or rental payments obtained from one or several third parties ('object financing exposures'), institutions shall apply the assessment criteria set out in Annex III to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013.

4. Where the purpose of a specialised lending exposure is to finance reserves, inventories or receivables of exchange-traded commodities, including in particular crude oil, metals, or crops, and the income to be generated by those reserves, inventories or receivables is to be the proceeds from the sale of the commodity ('commodities financing exposures'), institutions shall apply the assessment criteria set out in Annex IV to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013.

Article 2

Assessment at factor level and risk weight assignment

1. Institutions shall, on the basis of an overall assessment, attribute a category to each factor set out in the annex which is applicable to the class of specialised lending exposures in accordance with Article 1. For each specialised lending exposure, the institution shall carry out this attribution taking into consideration the categories attributed to each applicable sub-factor in accordance with Articles 3 and 4, as well as the relative importance of each sub-factor for the type of specialised lending exposures as defined in point (2) of Article 142(1) of Regulation (EU) No 575/2013.
2. The institution shall assign a weight in percentage that is not lower than 5% and not higher than 60% to each factor having regard to its relative importance for the type of specialised lending exposures.
3. The institution shall determine the weighted average of the categories, which have been attributed to the factors in accordance with paragraph 1, applying the weights assigned in accordance with paragraph 2. Where the weighted average is a decimal number, institutions shall round that number to the nearest cardinal number.
4. The institution shall assign the specialised lending exposure to the category set out in Table 1 of Article 153(5) of Regulation (EU) No 575/2013 for which the number corresponds to the weighted average calculated in accordance with paragraph 3.

Article 3

Assessment at sub-factor level

1. Where a sub-factor of a given factor listed in Annex I, II, III or IV is not further specified in sub-factor components, the institution shall attribute a category to the sub-factor on the basis of the assessment criteria set out for that sub-factor.
2. Where a sub-factor of a given factor listed in Annex I, II, III or IV is further specified in sub-factor components, the institution shall:
 - (a) attribute a category to each sub-factor component on the basis of the assessment criteria set out for that sub-factor component;
 - (b) attribute a category to the sub-factor on the basis of an overall assessment carried out taking into consideration the categories attributed in accordance

with point (a) as well as the relative importance of each sub-factor component for the type of specialised lending exposure.

3. Where the institution takes into account additional relevant information (an ‘additional risk driver’) in accordance with Article 171(2) of Regulation (EU) No 575/2013 for a type of specialised lending exposures, it shall consider it jointly with the sub-factor, which most closely corresponds to that additional risk driver.
4. Where, exceptionally, a sub-factor or sub-factor component is not relevant for all specialised lending exposures belonging to a certain type of specialised lending exposures, the institution may decide not to apply that sub-factor or sub-factor component for any of the specialised lending exposures belonging to that type.

Article 4

Overlapping criteria at sub-factor and sub-factor component levels

Where a sub-factor or a sub-factor component has identical assessment criteria in two or more categories (‘overlapping criteria’), and the specialised lending exposure conforms to those overlapping criteria, institutions shall attribute a category to the sub-factor or sub-factor component as follows:

- (a) where overlapping criteria occur in two categories, institutions shall attribute the higher of the two categories;
- (b) where overlapping criteria occur in three categories, institutions shall attribute the category between the lowest and the highest of the three categories.

Article 5

Default of an obligor

By way of derogation from Articles 1 to 4, where the obligor is in default in the meaning of Article 178 of Regulation (EU) No 575/2013, the institution shall assign a risk weight of category 5 as set out in Table 1 of Article 153(5) of that Regulation to the specialised lending exposure.

Article 6

Documentation

1. Institutions shall document the following information for each type of specialised lending exposures for which they assign risk weights in accordance with this Regulation:
 - (a) the assignment of weights to each factor in accordance with Article 2(2) and the justification for that assignment;
 - (b) a description of additional risk drivers and a justification for taking them into account in accordance with Article 3(3), where applicable;
 - (c) the justification for deciding not to apply a certain sub-factor or sub-factor component in accordance with Article 3(4), where applicable.
2. Institutions shall document the following information for each specialised lending exposure for which they assign risk weights in accordance with this Regulation:
 - (a) the class of the specialised lending exposure as set out in Article 1;

- (b) the category of Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013 to which the specialised lending exposure has been assigned;
- (c) the remaining maturity as referred to in Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013;
- (d) the assessment of the specialised lending exposure at each step of the process laid down in Articles 2 to 5 that led to the assignment of the risk weight to the exposure.

Article 7
Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [Instructions to the PO: insert a date one year after the date of publication].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 14.12.2020

For the Commission
The President
Ursula VON DER LEYEN