

# ALLEN & OVERY



## Capital Requirements Directive IV Framework *European Additions to Basel III*

Allen & Overy Client Briefing Paper 17 | January 2014

# CRD IV Framework: *European Additions to Basel III*

This briefing paper is part of a series of briefings on the implementation of Basel III in Europe via the Capital Requirements Directive IV<sup>1</sup> (**CRD IV**) and the Capital Requirements Regulation<sup>2</sup> (**CRR**), replacing the Banking Consolidation Directive<sup>3</sup> and Capital Adequacy Directive.<sup>4</sup> The legislation is highly complex: these briefings are intended to provide a high-level overview of the architecture of the regulatory capital and liquidity framework and to draw attention to the legal issues likely to be relevant to the in-house lawyer.

This briefing is for general guidance only and does not constitute definitive advice.

**NOTE: In relation to the topics discussed in this briefing, CRD IV and the CRR contain a number of discretions for Member States in relation to national implementation. The regime may therefore differ across Member States in a number of respects.**

**This briefing paper is based on information available as of 17 January 2014.**

## Background and scope

CRD IV and the CRR recast and replace the Capital Requirements Directive (ie the Banking Consolidation Directive and Capital Adequacy Directive – 2006/48/EU and 2006/49/EU) (**CRD**) and apply from 1 January 2014. Whilst they primarily represent the European Commission's implementation of the revisions to the **Basel Accord** known as **Basel III**, they also introduce a number of important changes to the banking regulatory framework that were not provided for under the Basel proposals.

In addition to these changes, the CRR also provides for a 'single rulebook' in that it produces, for the first time, a single set of prudential rules for credit institutions and investment firms (together, **firms**) that are directly applicable in member states. The intention behind this is to ensure uniform application of Basel III in Europe. The new rules in the CRR remove a significant number of national options and discretions from the current CRD. They allow member states to apply stricter requirements only where these are justified by national circumstances, needed on financial stability grounds or because of a firm's specific risk profile.

This briefing summarises the new rules on corporate governance, systems and controls, recovery and resolution planning, disclosure, remuneration, reliance on external credit ratings, credit risk adjustments, supervisory reporting requirements and sanctions under CRD IV and the CRR.

## Sources

Corporate Governance, Systems and Controls:  
CRD IV (*Directive 2013/36/EU*): Articles 76 - 91;  
CRR (*Regulation 575/2013*): Article 435.

Recovery and resolution planning: CRD IV  
(*Directive 2013/36/EU*): Article 74.

Disclosure: CRD IV (*Directive 2013/36/EU*): Articles 89-90.

Remuneration: CRD IV (*Directive 2013/36/EU*): Articles 92-95;  
CRR (*Regulation 575/2013*): Article 450.

Reliance on external credit ratings: CRD IV (*Directive 2013/36/EU*):  
Article 77 ; CRR (*Regulation 575/2013*): Articles 111-141.

Credit risk adjustments: CRR (*Regulation 575/2013*): Article 110.

Supervisory reporting requirements: CRR (*Regulation 575/2013*):  
Articles 99, 100, 101 and 394.

Sanctions: CRD IV (*Directive 2013/36/EU*): Articles 64-72.

UK Financial Conduct Authority (**FCA**) Policy Statement (*PS13/10*)  
CRD IV for Investment Firms (December 2013).

UK Prudential Regulation Authority (**PRA**) Policy Statement (*PS7/13*)  
Strengthening Capital Standards: Implementing CRD IV, feedback  
and final rules (December 2013) (the **PRA Policy Statement**).

PRA Supervisory Statement (*SS16/13*) Large Exposures (December  
2013) (the **PRA Supervisory Statement on Large Exposures**).

PRA Supervisory Statement (*SS10/13*) Credit Risk – Standardised  
Approach (December 2013) (the **PRA Policy Statement on Credit  
Risk – Standardised Approach**).

1\_2013/36/EU.

2\_Regulation 575/2013.

3\_2006/48/EU.

4\_2006/49/EU.

## Corporate governance, systems and controls

The corporate governance provisions found within CRD IV and the CRR build upon work already undertaken by the European Commission and are designed to further reduce excess risk taking by firms. CRD IV contains additional requirements on the nature and composition of management bodies and risk management arrangements whereas the CRR requires firms to make increased Pillar Three disclosures.

Although CRD required firms to have robust governance arrangements in place and at least two experienced individuals effectively directing the business, the European Commission believes that weaknesses in corporate governance contributed to the financial crisis. Of particular concern was the perceived failure by boards to exercise sufficient risk oversight and establish appropriately strong risk management functions – this, in their view, was combined with supervisors being incapable of identifying weaknesses within the risk governance frameworks. In order to combat these concerns, CRD IV introduces new requirements in relation to management bodies which include:

- All members of the management body must be of sufficiently good reputation and in possession of adequate knowledge, skills and experience not only to perform their duties but also to ensure the independence of mind necessary to constructively challenge and oversee the decisions of management. Members must act with honesty, integrity and independence. The combined management body will be required to possess adequate collective knowledge and skills to enable it to understand the main risks arising from activities across the firm as a whole. The firm must devote adequate resources to the induction and training of the management body.

- Members are required to commit sufficient time to perform their functions with limits being placed on the number of directorships and non-executive directorships a member of the management body can hold. For “significant firms”, there are explicit limits on the combination of directorships.
- The management body is responsible for the implementation of effective and prudent governance arrangements which consider the segregation of duties within the firm and the prevention of conflicts of interest.
- “Significant firms” must establish a nomination committee. When recruiting members to the management body, firms must consider a broad range of qualities and competencies, including diversity. The European Commission believes that diversity in board composition will “provide a broader range of views and opinions and therefore avoid the phenomenon of group think”.<sup>5</sup>

In relation to risk management arrangements, CRD IV requires that:

- The management body be responsible for the firm’s overall risk strategy and for the adequacy of the firm’s risk management system, and must devote sufficient time to risk issues.
- “Significant firms” establish a separate risk committee, composed of non-executive members, who advise the management body on the firm’s overall current and future risk appetite and strategy and assist in the risk oversight role – although the management body will remain ultimately accountable. Non-significant firms may combine the risk committee with the audit committee.

<sup>5</sup> European Commission: *Capital Requirements – CRD IV/CRR – Frequently Asked Questions*.

- Firms establish a risk management function that is independent from operational functions and has been granted sufficient authority, stature, resources and access to the management body. In “significant firms”, the risk management function must be headed by an independent senior manager who has distinct responsibility for that function.
- Supervisors assess whether firms have implemented policies and processes to evaluate and manage the exposure to risks such as operational risk, concentration risk, credit and counterparty risk, market risk, liquidity risk and risk of excessive leverage. New requirements apply in respect of systems and controls on liquidity risk profiles, credit risk, market risk and leverage risk.

## Recovery and resolution planning

Article 74(4) of CRD IV requires the generation of recovery and resolution plans. Recovery plans fall to the firm; resolution plans to the competent authorities.

The requirement is tempered by the principle of proportionality: the requirements may be reduced if the authorities consider that the firm is non-systemic.

## Disclosure

CRD IV seeks to improve the transparency of firm activities by requiring annual disclosure of profits, taxes and subsidies in different jurisdictions from 1 January 2015. It also requires disclosure of return on assets in the annual report.

The CRR supports the strengthened governance provisions by also requiring firms to make increased Pillar Three

disclosures in relation to their risk management objectives and policies (for each separate category of risk) and their enhanced governance arrangements, including the policy on diversity and the existence of a separate risk committee (where applicable). It also mandates disclosure of firms’ leverage ratios from 2015.

### “Significant firms” – additional obligations and scope

A number of CRD IV requirements are limited in scope to “significant firms”. These include requirements regarding:

- the requirement to establish an independent risk committee;
- the requirement to establish an independent nominations committee;
- the requirement to separate the CEO and chairperson role, and limitations on the number of directorships an individual may hold;
- the requirement to establish an independent remuneration committee;
- supervisory stress testing;
- the capital conservation buffer and the counter-cyclical capital buffer;
- the scope of liquidity reporting on an individual basis;
- the scope of liquidity reporting on a consolidated basis; and
- remuneration disclosure.

CRD IV does not specify what amounts to a “significant firm” for these purposes. In the UK the PRA has provided guidance that firms within its impact categories 1 or 2 are significant for this purpose. The FCA has set out in IFPRU section 1.2 tests to assess what classes of investment firms will be “significant”. These are based on quantitative tests of balance sheet assets, liabilities, annual fee and commission income, client money and client assets.

## Remuneration

As a result of the amendments under Capital Requirements Directive III (*Directive 2010/76/EU*) (**CRD III**), CRD required firms to have in place remuneration policies and practices that did not encourage or reward excessive risk taking and to make disclosures about the approach adopted in relation to certain prescribed employees. In addition to those existing disclosure requirements provided for under CRD (which are now set out in the CRR), the CRR also requires firms to disclose:

- The number of individuals being remunerated EUR1 million or more per financial year, broken down into pay bands of EUR500,000; and
- Upon request, the total remuneration for each member of the management body or senior management.

In addition to reproducing the CRD III remuneration requirements, CRD IV applies those requirements more widely at group and solo levels. It also introduces new provisions concerning the relationship between the variable (or bonus) component of remuneration and the fixed component (salary). The basic fixed to variable ratio will be 1:1, although this ratio can be raised to a maximum of 2:1, if a quorum of shareholders representing 50% of shares participate in the vote and a 66% majority of them support the measure. If the quorum cannot be reached, the measure can also be approved if it is supported by 75% of shareholders present. In this context, for the purposes of calculating the maximum ratio, the use of deferred and bail-in-able instruments is encouraged through the

application of a notional discount factor to up to 25% of total variable remuneration, provided that it is paid in instruments which are deferred for more than five years. In addition to these conditions, up to 100% of total variable pay must be subject to malus or clawback.

As with the old CRD III rules, the new requirements apply in accordance with the ‘proportionality principle’: they apply proportionately to a firm’s size, internal organisation and the nature, scale and complexity of their activities. The requirement also applies only to staff whose professional activities have a material impact on their risk profile, such as senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers. However, in response to concerns that firms and regulators have assessed this inconsistently, with firms tending to select low numbers of identified staff, the European Banking Authority (**EBA**) has developed draft regulatory standards with respect to qualitative and appropriate quantitative criteria to identify such staff.<sup>6</sup>

The rules apply to EEA-based firms across their group operations, including to non-EEA based branches and subsidiaries. Non-EEA based firms must apply them to EEA subsidiaries and to EEA branch operations. The rules will apply to pay awarded for services provided or performed from the year 2014 onwards, whether under contracts concluded before or after 1 January 2014. They will therefore affect bonuses payable in 2015.

<sup>6</sup> EBA/RTS/2013/11

## Reliance on external credit ratings

The CRD (following Basel II) allowed firms to use external credit assessments to determine the risk weight of their exposures provided the relevant institutions had been recognised by the supervising authorities. Following the financial crisis, there was a global consensus that banks had relied too heavily on external ratings, which led them to neglect their own independent assessment of risks. As a result, the Financial Stability Board (**FSB**) published a report<sup>7</sup> setting out principles for reducing reliance on credit rating agencies (**CRA**) ratings in rules and regulations to incentivise improvements in independent credit risk assessment by financial institutions.

As set out in a paper published by the Basel Committee on Banking Supervision (**BCBS**) in December 2010,<sup>8</sup> the Basel III reforms were structured to support the FSB approach by including measures intended to discourage banks' over-reliance on CRA ratings – for example, requiring them to perform their own internal assessments of externally rated securitisation exposures and eliminating the 'cliff effects' associated with credit risk mitigation practices. These had developed as a result of the drafting of Basel II, which arguably encouraged banks not to seek ratings on positions just below the capital requirements 'cliff' and to rely on ratings just above the 'cliff'. Despite the BCBS' requirements, the European Commission have stated that their measures are a European addition to Basel III.<sup>9</sup>

In relation to securitisation exposures, the Capital Requirements Directive II (2009/111/EC) (**CRD II**) introduced measures for due diligence requirements relating to securitisations which were intended to reduce the over-reliance on ratings. As a result, the European Commission may have concluded that Europe had already provided a solution for this issue. In relation to eliminating the 'cliff effect', it is arguable that the following provisions seek to achieve this in addition to reducing reliance more generally:

- CRD IV provides that competent authorities must encourage “significant firms” (in terms of scale, nature and complexity) to use internal models, rather than the standardised approach, where they have a material number of credit risk exposures or a significant number of counterparties in a particular portfolio. A similar requirement is included in relation to debt instruments in the trading book.
- Competent authorities will also be required to monitor that firms do not rely 'solely or mechanically' on external ratings for assessing the creditworthiness of an entity or a financial instrument, taking into account their nature, scale and complexity.
- On an annual basis, the EBA is required to disclose information on the steps taken by firms and competent authorities to reduce over-reliance, as well as on European convergence on the topic.

7\_FSB: Principles for reducing reliance on CRA ratings: 27 October 2010.

8\_Basel III: A global regulatory framework for more resilient banks and banking systems (BCBS 189): December 2010 (revised June 2011).

9\_European Commission: Capital Requirements – CRD IV/CRR: Frequently asked questions.

## Credit risk adjustments

The CRR defines credit risk adjustments as “the amount of specific and general loan loss provision for credit risks recognised in the financial statements of the institution in accordance with the applicable accounting framework”. The term was introduced in order to broadly replace the term ‘value adjustment’ that was used in the CRD. The European Commission are of the view that ‘value adjustment’ does not lend itself to a precise and comprehensive definition – partly as a result of the different accounting conventions.

The CRR sets out how firms should treat general and specific credit risk adjustments, with the EBA being

required to produce standards that specify how such adjustments should be calculated. The final draft technical standards published in July 2013<sup>10</sup> also provide criteria for determining whether adjustments should be considered specific or general. In December 2013, the European Commission further published a Commission delegated regulation on prudential requirements for credit institutions and investment firms, with regard to the RTS mentioned above.<sup>11</sup>

## Supervisory reporting requirements

The CRR introduces common reporting standards for firms in relation to capital (**COREP**) and financial reporting (**FINREP**) from 1 January 2014. COREP reporting obligations apply to all firms. FINREP reporting obligations apply to those firms which provide consolidated accounts. EU member states may retain some local reporting requirements.

In July 2013, the EBA published final draft technical standards<sup>12</sup> which specify the uniform formats, frequencies, dates of reporting, definitions and IT solutions to be applied by firms both on an individual and a consolidated level

(with the exception of financial information).

Originally these standards were due by 1 January 2012 but the EBA delayed the timing at the end of 2011 in order to be able to adopt the CRR final provisions. As well as the main provisions covering reporting requirements, the EBA has published a set of templates and related instructions, a set of data point descriptions and a set of validation formulae.

In January 2014, the European Commission published draft implementing technical standards with regard to supervisory reporting of institutions under the CRR.<sup>13</sup>

<sup>10</sup> EBA/RTS/2013/04.

<sup>11</sup> Delegated regulation on prudential requirements for credit institutions and 2014 investment firms (December 2013).

<sup>12</sup> EBA/ITS/2013/02.

<sup>13</sup> Draft ITS on the supervisory reporting of institutions (January 2014).



## Sanctions

As a result of divergences between sanctioning regimes applicable to breaches of CRD, the European Commission has, through CRD IV, introduced certain minimum requirements regarding administrative sanctions – the requirements do not extend to cover criminal sanctions. Those minimum requirements include:

- Member states ensuring that for breaches of key elements of CRD IV (for example, commencing banking activities without obtaining a licence), a minimum set of penalties and other sanctions are available in relation to both firms and individuals responsible for the breach. These include public censure, cease and desist orders, withdrawal of authorisations, pecuniary sanctions and temporary bans for management body members.
- In determining the appropriate level and type of sanction to be applied, competent authorities being required to consider certain minimum criteria such as the gravity and duration of the breach, the degree of cooperation and any potential systemic consequences.
- Competent authorities being required to publish the details of any sanction imposed on a firm or individual unless such publication would give rise to a risk of financial instability or jeopardise a criminal investigation, in which case the publication is required to be on an anonymous basis.
- Competent authorities sharing (subject to confidentiality laws) the details of all administrative penalties with the EBA in order to allow the information to be maintained on a central database. The EBA will ensure that the database is accessible to all competent authorities to allow for the exchange of information across EU member states.
- Competent authorities establishing an appropriate whistleblowing framework which provides employees with adequate protection.

# EBA technical standards and guidelines

CRD IV and the CRR mandate that various technical standards and guidelines shall be produced. In connection with European Additions to Basel III, the following technical standards and guidelines shall be produced:

CRD IV/CRR SOURCE	TECHNICAL STANDARDS/ GUIDELINES REQUIRED	DEADLINE FOR SUBMISSION TO THE EUROPEAN COMMISSION	EBA AND OTHER PUBLICATIONS
Article 74 CRD IV <i>(Internal governance and recovery and resolution plans)</i>	Guidelines on the arrangements, processes and mechanisms referred to in Article 74(1), in accordance with Article 74(2).	Not specified.	EBA/ESMA/EIOPA: Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes (November 2013). <a href="#">(JC-2013-77)</a>
Article 77 CRD IV <i>(Internal Approaches for calculating own funds requirements)</i>	Draft regulatory technical standards to further define the notion 'exposures to specific risk which are material in absolute terms' referred to in the first subparagraph of Article 77(3) and the thresholds for large numbers of material counterparties and positions in debt instruments of different issuers.	1 January 2014.	Consultation on draft regulatory technical standards on the definition of materiality thresholds for specific risk in the trading book under Article 77 of CRD IV (July 2013). <a href="#">(EBA/CP/2013/33)</a>  Final draft regulatory technical standards on the definition of materiality thresholds for specific risk in the trading book under Article 77 of CRD IV (December 2013). <a href="#">(EBA/RTS/2013/14)</a>
Article 78(7) CRD IV <i>(Supervisory benchmarking of internal approaches for calculating own funds requirements)</i>	Draft regulatory technical standards to specify: (a) the procedures for sharing assessments made in accordance with Article 78(3) between the competent authorities and with EBA; (b) the standards for the assessment made by competent authorities referred to in Article 78(3).	1 January 2014.	None to date.
Article 78(8) CRD IV <i>(Supervisory benchmarking of internal approaches for calculating own funds requirements)</i>	Draft implementing technical standards to specify: (a) the template, the definitions and the IT-solutions to be applied in the Union for the reporting referred to in paragraph 2; (b) the benchmark portfolio or portfolios referred to in Article 78(1).	1 January 2014.	None to date.

CRD IV/CRR SOURCE	TECHNICAL STANDARDS/ GUIDELINES REQUIRED	DEADLINE FOR SUBMISSION TO THE EUROPEAN COMMISSION	EBA AND OTHER PUBLICATIONS
Article 91 (12) CRD IV <i>(Management body)</i>	Guidelines on the following: (a) the notion of sufficient time commitment of a member of the management body to perform his functions, in relation to the individual circumstances and the nature, scale and complexity of activities of the institution; (b) the notion of adequate collective knowledge, skills and experience of the management body as referred to in Article 92(7); (c) the notions of honesty, integrity and independence of mind of a member of the management body as referred to in Article 91(8); (d) the notion of adequate human and financial resources devoted to the induction and training of members of the management body as referred to in Article 91(9); (e) the notion of diversity to be taken into account for the selection of members of the management body as referred to in Article 91(10).	31 December 2015.	None to date.
Article 94(1) CRD IV <i>(Variable elements of remuneration)</i>	Guidelines on the applicable notional discount rate taking into account all relevant factors including inflation rate and risk, which includes length of deferral.	31 March 2014.	Consultation on draft guidelines on the applicable notional discount rate for variable remuneration under Article 94(1)(g)(iii) of CRD IV (October 2013). <a href="#">(EBA/CP/2013/40)</a>
Article 94(2) CRD IV <i>(Variable elements of remuneration)</i>	Draft regulatory technical standards with respect to the criteria specifying the classes of instruments that satisfy the conditions set out in point (l)(ii) of Article 94(1) and with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on the institution's risk profile as referred to in Article 92(2).	31 March 2014.	Consultation on draft regulatory technical standards on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 90(2) CRD IV (May 2013). <a href="#">(EBA/CP/2013/11)</a>  Consultation Paper: Draft Regulatory Technical Standards on classes of instruments that are appropriate to be used for the purposes of variable remuneration under Article 94(2) of the Capital Requirements Directive (July 2013). <a href="#">(EBA/CP/2013/32)</a>  Final draft regulatory technical standards on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 94(2) (December 2013). <a href="#">(EBA/RTS/2013/11)</a>

CRD IV/CRR SOURCE	TECHNICAL STANDARDS/ GUIDELINES REQUIRED	DEADLINE FOR SUBMISSION TO THE EUROPEAN COMMISSION	EBA AND OTHER PUBLICATIONS
Article 99(5) CRR <i>(Reporting on own funds requirements and financial information)</i>	Draft implementing technical standards to specify the uniform formats, frequencies, dates of reporting, definitions and the IT solutions to be applied in the Union for the reporting referred to in Article 99(1) to 99(4).	28 July 2013 (amended by corrigendum). <sup>14</sup>	Consultation on draft implementing technical standards on supervisory reporting requirements for institutions (December 2011). <a href="#">(CP 50)</a>
Article 99(6) CRR <i>(Reporting on own funds requirements and financial information)</i>	Draft implementing technical standards to specify the formats to be used by institutions to which the competent authorities may extend the reporting requirements.		Consultation paper on draft implementing technical standards on Supervisory reporting on forbearance and non-performing exposures under article 95 of the CRR (March 2013). <a href="#">(EBA/CP/2013/06)</a>
Article 100 CRR <i>(Additional reporting requirements)</i>	Information on the level, at least in aggregate terms, of their repurchase agreements, securities lending and all forms of encumbrance of assets to be added to draft implementing technical standards required under Article 99.	1 June 2014 (amended by EBA-Commission agreement). <sup>15</sup>	Final draft implementing technical standards on supervisory reporting under CRR (July 2013). <a href="#">(EBA/ITS/2013/02)</a>
			Final draft implementing technical standards on draft Implementing technical standards on supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013 (October 2013) <a href="#">(EBA/ITS/2013/03)</a>
			<i>European Commission: Draft implementing technical standards with regard to supervisory reporting of institutions according to regulation (EU) No 575/2013 (January 2014).</i>
			Consultation paper on draft implementing technical standards on asset encumbrance reporting under article 95a of the CRR (March 2013). <a href="#">(EBA/CP/2013/05)</a>
			Final draft implementing technical standards On asset encumbrance reporting under Article 100 of the CRR (October 2013). <a href="#">(EBA/ITS/2013/04)</a>

<sup>14</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:208:0068:0072:EN:PDF> (August 2013)

<sup>15</sup> <http://www.eba.europa.eu/-/revised-deadlines-for-the-delivery-of-eba-technical-standards>

CRD IV/CRR SOURCE	TECHNICAL STANDARDS/ GUIDELINES REQUIRED	DEADLINE FOR SUBMISSION TO THE EUROPEAN COMMISSION	EBA AND OTHER PUBLICATIONS
<p>Article 101(4) CRR <i>(Specific reporting obligations)</i></p>	<p>Draft implementing technical standards to specify the following: (a) uniform formats, definitions, frequencies and dates of reporting, as well as the IT solutions, of the items referred to in Article 101(1); (b) uniform formats, definitions, frequencies and dates of reporting, as well as IT solutions, of the aggregate data referred to in Article 101(2).</p>	<p>28 July 2013 (amended by corrigendum).<sup>16</sup></p>	<p>Consultation on draft implementing technical standards on supervisory reporting requirements for institutions (December 2011). <i>(CP 50)</i></p> <p>Consultation paper on draft implementing technical standards on supervisory reporting on forbearance and non-performing exposures under article 95 of the CRR (March 2013). <i>(EBA/CP/2013/06)</i></p> <p>Final draft implementing technical standards on supervisory reporting under CRR (July 2013). <i>(EBA/ITS/2013/02)</i></p> <p>Consultation paper on draft implementing technical standards on asset encumbrance Reporting under article 95a of the CRR (March 2013). <i>(EBA/CP/2013/05)</i></p> <p><i>European Commission: Draft implementing technical standards with regard to supervisory reporting of institutions according to regulation (EU) No 575/2013 (January 2014).</i></p>
<p>Article 110 (4) CRR <i>(Treatment of credit risk adjustment)</i></p>	<p>Draft regulatory technical standards to specify the calculation of specific credit risk adjustments and general credit risk adjustments under the applicable accounting framework for the following: (a) exposure value under the Standardised Approach referred to in Article 111; (b) exposure value under the IRB Approach referred to in Articles 166 to 168; (c) treatment of expected loss amounts referred to in Article 159; (d) exposure value for the calculation of the risk-weighted exposure amounts for securitisation position referred to in Articles 246 and 266; (e) the determination of default under Article 178.</p>	<p>28 July 2013 (amended by corrigendum).<sup>17</sup></p>	<p>Consultation on draft regulatory technical standards on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) CRR (July 2012). <i>(EBA/CP/2012/10)</i></p> <p>Final draft regulatory technical standards on the specification of the calculation of specific and general credit risk adjustments in accordance with Article 110(4) CRR (July 2013). <i>(EBA/RTS/2013/04)</i></p> <p><i>European Commission: Regulatory technical standards for specifying the calculation of specific and general credit risk adjustments according to regulation (EU) No 575/2013 (December 2013).</i></p>

<sup>16</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:208:0068:0072:EN:PDF> (August 2013)

<sup>17</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:208:0068:0072:EN:PDF> (August 2013)

CRD IV/CRR SOURCE	TECHNICAL STANDARDS/ GUIDELINES REQUIRED	DEADLINE FOR SUBMISSION TO THE EUROPEAN COMMISSION	EBA AND OTHER PUBLICATIONS
Article 124 (4) CRR <i>(Exposures secured by mortgages on immovable property)</i>	Draft regulatory technical standards to specify (a) the rigorous criteria for the assessment of the mortgage lending value referred to in paragraph 1; (b) the conditions referred to in paragraph 2 that competent authorities shall take into account when determining higher risk-weights, in particular the term of "financial stability considerations."	31 December 2014.	None to date.
Article 128 (3) CRR <i>(Items associated with particular high risk)</i>	Guidelines specifying which types of exposures are associated with particularly high risk and under which circumstances.	Not specified.	None to date.
136(1) CRR <i>(Mapping of ECAI's credit assessments)</i>	Draft implementing technical standards to specify for all ECAs, with which of the credit quality steps set out in Section 2 the relevant credit assessments of the ECAI correspond ('mapping'). Those determinations shall be objective and consistent.	1 July 2014.	None to date.
Article 136(3) CRR <i>(Mapping of ECAI's credit assessments)</i>	Draft implementing technical standards to specify the quantitative factors referred to in point (a), the qualitative factors referred to in point (b) and the benchmark referred to in point (c) of paragraph 2.	1 July 2014.	None to date.
Article 394 CRR <i>(Reporting Requirements)</i>	Draft implementing technical standards to specify the following: (a) the uniform formats for the reporting referred to in Article 394(3) which shall be proportionate to the nature, scale and complexity of institutions' activities and the instructions for using those formats; (b) the frequencies and dates of the reporting referred to in Article 394(3); (c) the IT solutions to be applied for the reporting referred to in Article 394(3).	1 January 2014.	<p>Consultation on draft implementing technical standards on supervisory reporting requirements for large exposures (February 2012). <i>(CP51)</i></p> <p>Final draft implementing technical standards on supervisory reporting (July 2013). <i>(EBA/ITS/2013/02)</i></p> <p><i>European Commission: Draft Implementing Technical Standards with regard to supervisory reporting of institutions (January 2014).</i></p>

# National discretions and UK implementation

CRD IV and the CRR provide member states, “competent authorities” with certain discretions:

CRR/CRD IV SOURCE	NATURE OF DISCRETION	FCA / PRA PROPOSAL TO EXERCISE DISCRETION
Article 74(4) CRD IV <i>(Internal governance and recovery and resolution plans)</i>	In accordance with the principle of proportionality, the requirements for an institution to draw up, maintain and update recovery plans and for the resolution authority, after consulting a competent authority, to prepare resolution plans, may be reduced if, after consulting the national macro-prudential authority, the competent authority considers that the failure of a specific institution due, inter alia, to its size, to its business model, to its interconnectedness to other institutions, or to the financial system in general, will not have a negative effect on financial markets, on other institutions or on funding conditions.	In respect of FCA authorised firms, the FCA intends to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).  See SYSC 19A.3.12.
Article 76(3) CRD IV <i>(Treatment of risks)</i>	A competent authority is permitted to allow a firm is not considered 'significant' to merge its risk and audit committees.	In respect of FCA authorised firms, the FCA intends to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).  See SYSC 7.1.18.
Article 88(1)(e) CRD IV <i>(Governance arrangements)</i>	An individual will not be allowed to simultaneously carry out the CEO and chairperson function within an institution, unless explicitly authorised to do so by a competent authority.	In respect of FCA authorised firms, the FCA intends to exercise this discretion (subject to HMT decision). The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).  See SYSC 4.3A.2.
Article 88(2) CRD IV <i>(Governance arrangements)</i>	Discretion for member states to allow a firm that is not considered 'significant' not to establish a nominations committee.	In respect of FCA authorised firms, the FCA intends to exercise this discretion (subject to HMT's decision).  See SYSC 4.3A.8 to 4.3A.9.
Article 91 CRD IV <i>(Management body)</i>	A competent authority may authorise members of the management body to hold one additional non-executive directorship.  The number of directorships a member of the management body can hold at the same time shall take into account individual circumstances and the nature, scale and complexity of the institution's activities.	In respect of FCA authorised firms, the FCA intends to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).  See SYSC 4.3A.3 to 4.3A.7 and SYSC 4.3A.9 to 4.3A.10.

CRR/CRD IV SOURCE	NATURE OF DISCRETION	FCA / PRA PROPOSAL TO EXERCISE DISCRETION
<p>Article 95 CRD IV <i>(Remuneration Committee)</i></p>	<p>A competent authority may allow a firm that is not considered 'significant' not to establish a remuneration committee.</p>	<p>In respect of FCA authorised firms, the FCA intends to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).</p> <p>See SYSC 19A.3.12.</p>
<p>Article 99(6) CRR <i>(Reporting on own funds requirements and financial information)</i></p>	<p>Where a competent authority considers that the financial information required by paragraph 2 of this provision is necessary to obtain a comprehensive view of the risk profile of the activities of, and a view of the systemic risks to the financial sector or the real economy posed by, institutions -other than those referred to in paragraphs 2 and 3 that are subject to an accounting framework based on Directive 86/635/EEC, a competent authority shall consult EBA on the extension of the reporting requirements of financial information on a consolidated basis to those institutions, provided that they are not already reporting on such a basis.</p>	<p>In respect of FCA authorised firms, the FCA does not intend to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).</p> <p>See amendments to the Supervision Manual (SUP) 13.3.19A and 13.3.19B.</p>
<p>Article 113(6) CRR <i>(Calculation of risk weighted exposure amounts)</i></p>	<p>A competent authority may allow firms to reduce/ waive risk weights to intra-group exposures providing that certain conditions are met.</p>	<p>In respect of FCA authorised firms, the FCA intends to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).</p> <p>In respect of PRA authorised firms, the PRA intends to refer to the counterparties in respect of which a firm benefits from a large exposure limit exemption in this way as the 'core UK group'. This is consistent with the pre-CRR/PRA approach. As the exposures which come under the scope of the core UK group are exempted through the operation of the CRR, rather than through PRA rules, the PRA has defined the core UK group in PRA rules with reference to CRR Article 400(1)(f). See the PRA Policy Statement at Chapter 12 (Large Exposures) paragraph 12.3.</p> <p>See the PRA Supervisory Statement on Large Exposures at paragraphs 2.1 to 2.9, 3.2 and 3.8.</p>
<p>Article 114(7), 115(4), 116(5), 132(3) CRR <i>(Exposures to central governments or central banks)</i> <i>(Exposures to regional governments or local authorities)</i> <i>(Exposures to public sector entities)</i> <i>(Exposures in the form of units or shares in CIUs)</i></p>	<p>The European Commission must produce a list of third country equivalents in relation to these articles by 1 January 2015. Until then a competent authority may continue to treat third country equivalents as such with the proviso that no additional third country equivalents can be approved in respect of these articles after 1 January 2014.</p>	<p>In respect of FCA authorised firms, the FCA intends to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).</p> <p>In respect of PRA authorised firms, the PRA will set out the approach to be taken during 2014 in the absence of an equivalent determination by the European Commission. See PRA Supervisory Statement on Credit risk – Standardised approach at paragraphs 3.1, 7.1(a) and 7.21.</p>



CRR/CRD IV SOURCE	NATURE OF DISCRETION	FCA / PRA PROPOSAL TO EXERCISE DISCRETION
<p>Article 124, 125 and 126 CRR</p> <p><i>(Exposures secured by mortgages on immovable property)</i></p> <p><i>(Exposures fully and completely secured by mortgages on residential property)</i></p> <p><i>(Exposures fully and completely secured by mortgages on commercial immovable property)</i></p>	<p>A competent authority may increase the risk weights on residential mortgage (35%) and commercial immovable property (50%) within certain thresholds or set stricter criteria than those in articles 125(2) and 126(2). The EBA should be consulted if this were exercised.</p>	<p>In respect of FCA authorised firms, the FCA intends to exercise these discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).</p> <p>In respect of PRA authorised firms, the PRA intends to consult on a rule to impose a stricter criterion/ higher risk weight for exposures secured on CRE in non-EEA states. A firm shall calculate the loss level referred to in this rule on the basis of the aggregate market data for commercial property lending published by the PRA in accordance with Article 101(3) of the CRR. For the purposes of this rule, a representative period shall be a time horizon of sufficient length and which includes a mix of good and bad years.</p> <p>The PRA expects exposures to Ijara mortgages to be subject to all of the requirements applicable to exposures secured by mortgages on residential property including in respect of periodic property revaluation. See PRA Policy Statement, chapter 7 (Credit risk) point 7.4 and Annex E point 4.1.</p> <p>See PRA Supervisory Statement (SS10/13) 5.1 to 5.2.</p>
<p>Article 129 CRR</p> <p><i>(Exposures in the form of covered bonds)</i></p>	<p>A competent authority may, after consulting the EBA, partly waive the application of point (c) of the first subparagraph and allow credit quality step 2 for up to 10 % of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution.</p>	<p>In respect of FCA authorised firms, the FCA does not intend to exercise this discretion. The FCA has set out whether it intends to exercise these discretions in Annex 3 (List of national discretions and FCA's approach to their application) to CP 13/6 CRD IV for Investment Firms (July 2013).</p> <p>In respect of PRA authorised firms, when determining the portion of a past due item that is secured, the PRA expects the secured portion of an exposure covered by a mortgage indemnity product that is eligible for credit risk mitigation purposes under Chapter 4 of the CRR potentially to be capable of qualifying as an eligible guarantee.</p> <p>See PRA Supervisory Statement (SS10/13) 6.1.</p>

## Contacts



**Kate Sumpter**  
Partner  
Tel +44 203 088 2054  
kate.sumpter@allenoverly.com



**Etay Katz**  
Partner  
Tel +44 20 3088 3823  
etay.katz@allenoverly.com



**Damian Carolan**  
Partner  
Tel +44 20 3088 2495  
damian.carolan@allenoverly.com



## Further reading

Client Briefing 1 (*Introduction to Regulatory Capital and Liquidity*)

