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From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	12 March 2014
To:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
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Subject:	COMMISSION DELEGATED REGULATION (EU) No .../.. of 12.3.2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach

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Delegations will find attached document C(2014) 1551 final.

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Brussels, 12.3.2014  
C(2014) 1551 final

**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of 12.3.2014**

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach**

(Text with EEA relevance)

## **EXPLANATORY MEMORANDUM**

### **1. CONTEXT OF THE DELEGATED ACT**

Articles 143(5) and 312(4)(b) and (c) of Regulation (EU) No 575/2013 ('the Regulation') empower the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Article 10 of Regulation No (EU) 1093/2010 establishing the EBA, delegated acts specifying the conditions for assessing the materiality of extensions and changes of internal approaches when calculating own funds requirements for credit and operational risk.

In accordance with Articles 10 to 15 of Regulation No (EU) 1093/2010 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 Articles 143(5) and 312(4)(b) and (c) of the Regulation. A consultation paper was published on 11 March 2013, and the consultation closed on 11 June 2013. 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 the consultation paper.

As specifically requested by the Commission, only the draft technical standards and explanatory memorandum are submitted to the Commission for the adoption of the RTS. All relevant background information - notably the background and rationale of the draft technical standards, the impact assessment and the feedback on the public consultation - is included in the full version of the EBA RTS, which was approved by the EBA's Board of Supervisors on 27 November 2013 and subsequently published on the EBA's public website: <https://www.eba.europa.eu/regulation-and-policy/model-validation/draft-regulatory-technical-standards-on-the-conditions-for-assessing-the-materiality-of-extensions-and-changes>.

### **3. LEGAL ELEMENTS OF THE DELEGATED ACT**

All the provisions in this delegated act relate to the assessment of the materiality of model changes and extensions of internal approaches when calculating own funds requirements for credit and operational risk. According to the Regulation, all institutions are required to apply for permission whenever they intend to implement any material extension and change to their internal approaches for credit and operational risk, to ensure that the approved internal approaches comply with the regulatory requirements.

The Regulation differentiates between material extensions or changes that are subject to approval, and all other changes that are subject to notification. In relation to the latter (extensions and changes subject to notification), the timing of notification is not specified, i.e. whether the extension or change should be notified before or after its implementation. Nevertheless, extensions and changes of minor importance need not be known to competent

authorities in advance of their implementation; instead it would be more efficient and less burdensome for institutions to collect information on such changes of minor importance and notify them to the competent authorities at regular intervals. Such an approach, which is already supervisory practice in several Member States, would reduce the supervisory burden for both the competent authorities and the institutions.

With the above considerations in mind, the core of the delegated act provides firstly (in the annexes) lists of qualitative conditions for classification of extensions and changes to the internal approaches (for each of the credit and operational risk areas) into one of the following categories: material extensions and changes which require a permission from the competent authorities; extensions and changes of a lesser materiality, but still of a degree of materiality that requires notification to the competent authorities before their implementation; and extensions and changes of an even lesser degree of materiality which therefore need only be notified to the competent authorities at regular intervals, after their implementation.

Those extensions and changes which fall under one of the categories of lesser materiality may still alter the own funds requirements or, where applicable, the risk-weighted exposure amounts. Hence the delegated act also includes quantitative thresholds to be applied as a 'back-stop' measure in addition to the lists of qualitative conditions when determining the materiality of an extension and change. These thresholds are based on the percentage change of own funds requirements or, where applicable, of risk-weighted exposure amounts before and after the planned extension or change.

Finally, the delegated act sets out the documentation to be submitted by institutions to competent authorities so that these authorities can assess compliance of institutions with the above rules.

**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of 12.3.2014**

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach**

(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 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, and in particular third subparagraph of Article 143(5) and third subparagraph of Article 312(4),

Whereas:

- (1) In accordance with Article 143(3) of Regulation (EU) No 575/2013 the range of application of a rating system refers to the type of exposures that may be rated with a specific rating system.
- (2) Regulation (EU) No 575/2013 differentiates between material extensions or changes to the Internal Ratings Based Approach (IRB approach) and Advanced Measurement Approach (AMA) that are subject to approval, and all other changes that are subject to notification. As to the latter there is no indication in Regulation (EU) No 575/2013 on the timing of notification of the extension or change, i.e. whether the change should be notified before or after its implementation. It should be considered that extensions or changes of minor importance need not be known to the competent authorities in advance. Further, it would also be more efficient and less burdensome for institutions to collect such changes of minor importance and notify them to the competent authorities in regular intervals. Indeed, this has already been supervisory practice in several Member States. Thus, extensions and changes requiring notification should be further split into extensions and changes requiring notification before their implementation and extensions and changes only requiring notification after their implementation. This would further ensure that competent authorities in their daily tasks focus their attention on extensions and changes with the potential of materially altering own funds requirements or the performance of the models or rating systems. It would also ensure that institutions distinguish between extensions and changes of great significance from extensions and changes of minor importance on the basis of a risk-oriented supervisory approach. Such a distinction between extensions and changes

subject to notification before implementation and extensions and changes subject to notification after implementation, would be prudent, given that the notification before implementation would provide the competent authorities with the possibility to review the correct application of this Regulation. This in return would also reduce the supervisory burden on the institutions' side.

- (3) Materiality of extensions or changes in the models usually depends on the type and category of the extension or change proposed (which should be reflected in qualitative criteria), and on their potential to alter the own funds requirements or, where applicable, the risk-weighted exposure amounts (which should be reflected in the quantitative criteria). Therefore any quantitative criteria for reviewing the materiality of extensions or changes should take the form of a threshold based on the percentage change of own funds requirements or, where applicable, of risk-weighted exposure amounts before and after the change.
- (4) While for extensions and changes to AMA approaches, the quantitative threshold should be calculated, for the sake of simplicity, on the basis of the own funds requirements, for changes to the IRB approaches the threshold should be calculated on the basis of risk-weighted exposure amounts, in order to avoid that the thresholds are unduly influenced by differences in the amounts of credit value adjustments made, which affect own funds requirements, but not risk-weighted exposure amounts. Moreover, quantitative thresholds should be designed to take into account the overall impact of the extensions or changes on the capital required based on the internal approaches as well as the standardised approaches, in order to reflect the extent to which internal approaches are used for the overall own funds requirements or risk-weighted exposure amounts. This applies to all thresholds for both approaches, except in relation to the second threshold in Article 4(1)(c)(ii) for the IRB approach and the prior notification threshold for the IRB approach which are designed with regard to the impact of changes on the risk-weighted exposure amounts covered by the range of application of a specific model. For both the IRB approach and the AMA, the calculations to derive the impact of a given extension or change should be made with reference to the same point in time, given that the set of exposures (in the case of the IRB approach) and the risk profile (in the case of the AMA) are relatively stable in time.
- (5) Competent authorities may at any time take appropriate supervisory measures with regard to model extensions and changes that have been notified, based on the on-going review of existing permissions to use internal approaches provided in Article 101 of Directive 2013/36/EU<sup>1</sup>. On the one hand, this is in order to ensure that the requirements laid down in Part Three, Title II, Chapter 3, Section 6, or Part Three, Title III, Chapter 4 or Part Three, Title IV, Chapter 5 of Regulation (EU) No 575/2013 remain satisfied. On the other hand, rules are necessary to establish the triggers for new approvals and notifications of extensions and changes to internal approaches. Such rules should not affect supervisory internal model review approaches or administrative processes provided for by Article 20(8) of Regulation (EU) No 575/2013.

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<sup>1</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

- (6) Changes to the permanent partial use of internal approaches or, where applicable, to the sequential implementation of internal approaches are covered by Articles 148 and 150 of Regulation (EU) No 575/2013 for IRB approach and Article 314 of Regulation (EU) No 575/2013 for AMA. Therefore those types of changes should not be covered by this Regulation.
- (7) The permission of competent authorities relates to the methods, processes, controls, data collection and IT systems of the approaches, therefore on-going alignment of the models to the calculation data-set used, based on the approved methods, processes, controls, data collection and IT systems, should not be covered by this Regulation.
- (8) In order for competent authorities to be able to assess that institutions have applied the rules on assessing the materiality of extensions and changes correctly, appropriate documentation should be submitted by institutions to competent authorities. In order to reduce the supervisory burden on institutions and to increase the effectiveness and efficiency of competent authorities' procedures in that respect, rules should be laid down to specify documentation requirements to accompany applications for approval or notifications of extensions and changes.
- (9) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (10) The provisions of this Regulation are closely linked, since they refer to extensions and/or changes to AMA and IRB approaches for own funds requirements for credit and operational risk and since relevant supervisory issues and procedures are similar for those two types of internal approaches. To ensure coherence between those provisions, and to facilitate a comprehensive view and access in a coordinated fashion to them by persons subject to relevant obligations, it is desirable that they enter into force at the same time and include all of the regulatory technical standards required by Regulation (EU) No 575/2013 on extensions and changes to internal models for credit and operational risk, in a single Regulation. However, since point (a) in the first subparagraph of Article 312(4) deals with a different subject matter, this regulation only addresses points (b) and (c).
- (11) 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 opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>2</sup>,

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<sup>2</sup> 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).

HAS ADOPTED THIS REGULATION:

### *Article 1*

#### *Subject matter*

This Regulation lays down the conditions for assessing the materiality of extensions and changes to the Internal Rating Based approaches and the Advanced Measurement Approaches permitted in accordance with Regulation (EU) 575/2013, including the modalities of the notifications of such changes and extentions.

### *Article 2*

#### *Categories of extensions and changes*

1. The materiality of changes to the range of application of a rating system or an internal models approach to equity exposures, or of changes to the rating systems or internal models approach to equity exposures, for the Internal Rating Based approach ('changes in the IRB approach') or of the extensions and changes for the Advanced Measurement Approach, ('extensions and changes in the AMA') shall be classified into one of the following categories:
  - (a) material extensions and changes, which, according to Articles 143(3) and 312(2) of Regulation (EU) No 575/2013, require permission from the competent authorities;
  - (b) other extensions and changes, which require notification to the competent authorities.
2. The extensions and changes referred to in point (b) of paragraph 1 shall further be classified into:
  - (a) extensions and changes that require notification before their implementation;
  - (b) extensions and changes that require notification after their implementation.

### *Article 3*

#### *Principles of classification of extensions and changes*

1. 1. The classification of changes in the IRB approach shall be carried out in accordance with this Article and Articles 4 and 5.

The classification of extensions and changes in the AMA shall be carried out in accordance with this Article and Articles 6 and 7.



2. Where institutions are required to calculate the quantitative impact of any extension or change on own funds requirements or, where applicable, on risk-weighted exposure amounts, they shall apply the following methodology:
  - (a) for the purpose of the assessment of the quantitative impact institutions shall use the most recent data available;
  - (b) where a precise assessment of the quantitative impact is not feasible, institutions shall instead perform an assessment of the impact based on a representative sample or other reliable inference methodologies;
  - (c) for changes having no direct quantitative impact, no quantitative impact as laid down in Article 4(1)(c) for IRB approach or Article 6(1)(c) for AMA shall be calculated.
3. One material extension or change shall not be split into several changes or extensions of lower materiality.
4. In case of doubt, institutions shall assign extensions and changes to the category of the highest potential materiality.
5. Where competent authorities have provided their permission in relation to a material extension or change, institutions shall calculate the own funds requirements based on the approved extension or change from the date specified in the new permission which shall replace the prior one. The non-implementation on the date specified in the new permission of an extension or change for which permission from competent authorities has been given, shall require a new permission from competent authorities which shall be applied for without undue delay.
6. In case of delay of the implementation of an extension or change for which permission from the competent authority has been granted, the institution shall notify the competent authority and present to the competent authority a plan for a timely implementation of the approved extension or change, which it shall apply within a period to be agreed with the competent authority.
7. Where an extension or change is classified as one requiring prior notification to competent authorities, and where, subsequently to the notification, institutions decide not to implement the extension or change, institutions shall notify without undue delay the competent authorities of this decision.

#### *Article 4*

##### *Material changes to the IRB approach*

1. Changes to the IRB approach shall be considered material if they fulfil any of the following conditions:
  - (a) they fall under any of the changes to the range of application of a rating system or internal models approach to equity exposures described in Annex I, Part I, Section 1;

- (b) they fall under any changes to the rating systems or internal models approach to equity exposures described in Annex I, Part II, Section 1;
- (c) they result in either of the following:
  - (i) a decrease of 1.5% of either of the following:
    - the overall EU parent institution’s consolidated risk-weighted exposure amounts for credit and dilution risk;
    - the overall risk-weighted exposure amounts for credit and dilution risk in the case of an institution which is neither a parent institution, nor a subsidiary;
  - (ii) a decrease of 15% or more of the risk-weighted exposure amounts for credit and dilution risk associated with the range of application of the internal rating system or internal models approach to equity exposures.

2. For the purposes of paragraph (1)(c)(i) of this Article, and in accordance with Article 3(2), the impact of the change shall be assessed as a ratio calculated as follows:

- (a) in the numerator, the difference in the risk-weighted exposure amounts for credit and dilution risk associated with the range of application of the internal rating system or the internal models approach to equity exposures before and after the change at the EU parent institution’s consolidated level or at the institution level which is neither a parent institution, nor a subsidiary;
- (b) in the denominator the overall risk-weighted exposure amounts for credit and dilution risk before the change at the EU parent institution’s consolidated level or, respectively, at the institution level which is neither a parent institution, nor a subsidiary.

The calculation shall refer to the same point in time.

The determination of the impact on risk-weighted exposure amounts shall refer only to the impact of the change to the IRB approach, and the set of exposures shall be assumed to remain constant.

3. For the purposes of paragraph (1)(c)(ii) of this Article, and in accordance with Article 3(2), the impact of the change shall be assessed as a ratio calculated as follows:

- (a) in the numerator, the difference in the risk-weighted exposure amounts for credit and dilution risk associated with the range of application of the internal rating system or the internal models approach to equity exposures before and after the change;
- (b) in the denominator, the risk-weighted exposure amounts for credit and dilution risk before the change associated with the range of application of the rating system or the internal models approach to equity exposures.

The calculation shall refer to the same point in time.

The determination of the impact on risk-weighted exposure amounts shall refer only to impact of the change to the IRB approach, and the set of exposures shall be assumed to remain constant.

## *Article 5*

### *Changes to the IRB approach not considered material*

1. Changes to the IRB approach, which are not material but are to be notified to competent authorities according to Article 143(4) of Regulation (EU) No 575/2013, shall be notified in the following manner:
  - (a) changes which fulfil any of the following conditions shall be notified to competent authorities at least two months before their implementation:
    - (i) changes described in Annex I, Part I, Section 2;
    - (ii) changes described in Annex I, Part II, Section 2;
    - (iii) changes which result in a decrease of at least 5% of the risk-weighted exposure amounts for credit and dilution risk associated with the range of application of the internal rating system or internal models approach to equity exposures.
  - (b) all other changes shall be notified to the competent authorities after their implementation at least on an annual basis.
2. For the purposes of paragraph (1)(a)(iii) of this Article, and in accordance with Article 3(2), the impact of the change shall be assessed as a ratio calculated as follows:
  - (a) in the numerator, the difference in the risk-weighted exposure amounts for credit and dilution risk associated with the range of application of the internal rating system or the internal models approach to equity exposures before and after the change;
  - (b) in the denominator, the risk-weighted exposure amounts for credit and dilution risk before the change associated with the range of application of the rating system or the internal models approach to equity exposures.

The calculation shall refer to the same point in time.

The determination of the impact on risk-weighted exposure amounts shall refer only to impact of the change to the IRB approach, and the set of exposures shall be assumed to remain constant.

## Article 6

### *Material extensions and changes to the AMA*

1. Extensions and changes to the AMA shall be considered material, if they fulfil any of the following conditions:
  - (a) they fall under any extensions described in Annex II, Part I, Section 1;
  - (b) they fall under any changes described in Annex II, Part II, Section 1;
  - (c) they result in either of the following:
    - (i) in a decrease of 10% or more of either of the following:
      - the overall EU parent institution's consolidated own funds requirements for operational risk;
      - the overall own funds requirements for operational risk in the case of an institution which is neither a parent institution, nor a subsidiary;
    - (ii) in a decrease of 10% or more of either of the following:
      - the overall own funds requirements for operational risk at the consolidated level of a parent institution which is not an EU parent institution;
      - the overall own funds requirements for operational risk of a subsidiary where the parent institution has not received the permission to use the AMA.
2. For the purposes of paragraph (1)(c)(i), and in accordance with Article 3(2), the impact of any extension or change shall be assessed as a ratio calculated as follows:
  - (a) in the numerator, the difference in the own funds requirements for operational risk associated with the scope of application of the AMA model before and after the extension or change at the EU parent institution's consolidated level or at the institution level which is neither a parent institution, nor a subsidiary;
  - (b) in the denominator, the overall own funds requirements for operational risk before the extension or change at the EU parent institution's consolidated level or, respectively, at the institution level which is neither a parent institution, nor a subsidiary.

The calculation shall refer to the same point in time.

The determination of the impact on the own funds requirements shall refer only to impact of the extension and change to the AMA, and therefore the operational risk profile shall be assumed to remain constant.

3. For the purposes of paragraph (1)(c)(ii), and in accordance with Article 3(2), the impact of any extension or change shall be assessed as a ratio calculated as follows:
  - (a) in the numerator, the difference in the own funds requirements for operational risk associated with the scope of application of the model before and after the extension or change at the consolidated level of a parent institution which is not an EU parent institution or at the subsidiary level where the parent institution has not received the permission to use the AMA;
  - (b) in the denominator, the overall own funds requirements for operational risk before the extension or change at the consolidated level of a parent institution which is not an EU parent institution or, respectively, at the subsidiary level where the parent institution has not received the permission to use the AMA.

The calculation shall refer to the same point in time.

The determination of the impact on the own funds requirements shall refer only to impact of the extension and change to the AMA, and therefore the operational risk profile shall be assumed to remain constant.

#### *Article 7*

##### *Extensions and changes to the AMA not considered material*

Extensions and changes to the AMA, which are not material but are to be notified to competent authorities according to Article 312(3) of Regulation (EU) No 575/2013, shall be notified in the following manner:

- (a) extensions and changes falling under Annex II, Part I, Section 2 and Part II, Section 2, shall be notified to competent authorities at least two months before their implementation;
- (b) all other extensions and changes shall be notified to the competent authorities after their implementation at least on an annual basis.

#### *Article 8*

##### *Documentation of extensions and changes*

1. For extensions and changes to the IRB approach or to the AMA classified as requiring competent authorities' approval, institutions shall submit, together with the application, the following documentation:
  - (a) description of the extension or change, its rationale and objective;
  - (b) implementation date;

- (c) scope of application affected by the model extension or change, with volume characteristics;
  - (d) technical and process document(s);
  - (e) reports of the institutions' independent review or validation;
  - (f) confirmation that the extension or change has been approved through the institution's approval processes by the competent bodies and date of approval;
  - (g) where applicable, the quantitative impact of the change or extension on the risk weighted exposure amounts or the own funds requirements;
  - (h) records of the institution's current and previous version number of internal models which are subject to approval.
2. For extensions and changes classified as requiring notification either before or after implementation, institutions shall submit, together with the notification, the documentation referred to in points (a), (b), (c), (f) and (g) of paragraph 1.

#### *Article 9*

#### *Entry into force*

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

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

Done at Brussels, 12.3.2014

*For the Commission*  
*The President*  
*José Manuel BARROSO*