

## CRR IV - Article 194

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Must lending institutions always obtain a written reasoned legal opinion in order to rely on their credit protection techniques for the purposes of Article 194(1) of the CRR? EBA answer

[http://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2013\\_23](http://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2013_23)

## CRR IV

Point (57) of Article 4(1) of Regulation (EU) No 575/2013 -

(57) 'credit risk mitigation' means a technique used by an institution to reduce the credit risk associated with an exposure or exposures which that institution continues to hold;

(58) 'funded credit protection' means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the right of that institution, in the event of the default of the counterparty or on the occurrence of other specified credit events relating to the counterparty, to liquidate, or to obtain transfer or appropriation of, or to retain certain assets or amounts, or to reduce the amount of the exposure to, or to replace it with, the amount of the difference between the amount of the exposure and the amount of a claim on the institution;

(59) 'unfunded credit protection' means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the obligation of a third party to pay an amount in the event of the default of the borrower or the occurrence of other specified credit events;

### Article 194

#### Principles governing the eligibility of credit risk mitigation techniques

1. The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by the lending institution shall be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.

The lending institution shall provide, upon request of the competent authority, the most recent version of the independent, written and reasoned **legal opinion** or opinions that it used to establish whether its credit protection arrangement or arrangements meet the condition laid down in the first subparagraph.

2. The lending institution shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address the risks related to that arrangement.

3. Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the assets relied upon for protection meet both of the following conditions:

(a) they are included in the list of eligible assets set out in Articles 197 to 200, as applicable;

(b) they are sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed.

4. Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the lending institution has the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy — or other credit event set out in the transaction documentation — of the obligor and, where applicable, of the custodian holding the collateral. The degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor shall not be too high.

5. In the case of unfunded credit protection, a protection provider shall qualify as an eligible protection provider only where the protection provider is included in the list of eligible protection providers set out in Article 201 or 202, as applicable.

6. In the case of unfunded credit protection, a protection agreement shall qualify as an eligible protection agreement only where it meets both the following conditions:

- (a) it is included in the list of eligible protection agreements set out in Articles 203 and 204(1);
- (b) it is legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed;
- (c) the protection provider meets the criteria laid down in paragraph 5.

7. Credit protection shall comply with the requirements set out in Section 3, as applicable.

8. An institution shall be able to demonstrate to competent authorities that it has adequate risk management processes to control those risks to which it may be exposed as a result of carrying out credit risk mitigation practices.

9. Notwithstanding the fact that credit risk mitigation has been taken into account for the purposes of calculating risk-weighted exposure amounts and, where applicable, expected loss amounts, institutions shall continue to undertake a full credit risk assessment of the underlying exposure and be in a position to demonstrate the fulfilment of this requirement to the competent authorities. In the case of repurchase transactions and securities lending or commodities lending or borrowing transactions the underlying exposure shall, for the purposes of this paragraph only, be deemed to be the net amount of the exposure.

10. EBA shall develop draft regulatory technical standards to specify what constitutes sufficiently liquid assets and when asset values can be considered as sufficiently stable for the purpose of paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 30 September 2014.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### *Article 207*

#### **Requirements for financial collateral**

1. Under all approaches and methods, financial collateral and gold shall qualify as eligible collateral where all the requirements laid down in paragraphs 2 to 4 are met.

2. The credit quality of the obligor and the value of the collateral shall not have a material positive correlation. Where the value of the collateral is reduced significantly, this shall not alone imply a significant deterioration of the credit quality of the obligor. Where the credit quality of the obligor becomes critical, this shall not alone imply a significant reduction in the value of the collateral.

Securities issued by the obligor, or any related group entity, shall not qualify as eligible collateral. This notwithstanding, the obligor's own issues of covered bonds falling within the terms of Article 129 qualify as eligible collateral when they are posted as collateral for a repurchase transaction, provided that they comply with the condition set out in the first subparagraph.

3. Institutions shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to their interest in the collateral.

Institutions shall have conducted sufficient **legal review** confirming the enforceability of the collateral arrangements in all relevant jurisdictions. They shall re-conduct such review as necessary to ensure continuing enforceability.

4. Institutions shall fulfil all the following operational requirements:

(a) they shall properly document the collateral arrangements and have in place clear and robust procedures for the timely liquidation of collateral;

(b) they shall use robust procedures and processes to control risks arising from the use of collateral, including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the institution's overall risk profile;

(c) they shall have in place documented policies and practices concerning the types and amounts of collateral accepted;

(d) they shall calculate the market value of the collateral, and revalue it accordingly, at least once every six months and whenever they have reason to believe that a significant decrease in the market value of the collateral has occurred;

(e) where the collateral is held by a third party, they shall take reasonable steps to ensure that the third party segregates the collateral from its own assets;

(f) they shall ensure that they devote sufficient resources to the orderly operation of margin agreements with OTC derivatives and securities-financing counterparties, as measured by the timeliness and accuracy of their outgoing margin calls and response time to incoming margin calls;

(g) they shall have in place collateral management policies to control, monitor and report the following:

(i) the risks to which margin agreements expose them;

(ii) the concentration risk to particular types of collateral assets;

(iii) the reuse of collateral including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties;

(iv) the surrender of rights on collateral posted to counterparties.

5. In addition to meeting all the requirements set out in paragraphs 2 to 4, for financial collateral to qualify as eligible collateral under the Financial Collateral Simple Method the residual maturity of the protection shall be at least as long as the residual maturity of the exposure

#### *Article 209*

#### **Requirements for receivables**

1. Receivables shall qualify as eligible collateral where all the requirements laid down in paragraphs 2 and 3 are met.

2. The following requirements on legal certainty shall be met:

(a) the legal mechanism by which the collateral is provided to a lending institution shall be robust and effective and ensure that that institution has clear rights over the collateral including the right to the proceeds from the sale of the collateral;

(b) institutions shall take all steps necessary to fulfil local requirements in respect of the enforceability of security interest. Lending institutions shall have a first priority claim over the collateral although such claims may still be subject to the claims of preferential creditors provided for in legislative provisions;

(c) institutions shall have conducted sufficient **legal review** confirming the enforceability of the collateral arrangements in all relevant jurisdictions;

(d) institutions shall properly document their collateral arrangements and shall have in place clear and robust procedures for the timely collection of collateral;

(e) institutions shall have in place procedures that ensure that any legal conditions required for declaring the default of a borrower and timely collection of collateral are observed;

(f) in the event of a borrower's financial distress or default, institutions shall have legal authority to sell or assign the receivables to other parties without consent of the receivables obligors.

3. The following requirements on risk management shall be met:

(a) an institution shall have in place a sound process for determining the credit risk associated with the receivables. Such a process shall include analyses of a borrower's business and industry and the types of customers with whom that borrower does business. Where the institution relies on its borrowers to ascertain the credit risk of the customers, the institution shall review the borrowers' credit practices to ascertain their soundness and credibility;

(b) the difference between the amount of the exposure and the value of the receivables shall reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual borrower, and potential concentration risk within the institution's total exposures beyond that controlled by the institution's general methodology. Institutions shall maintain a continuous monitoring process appropriate to the receivables. They shall also review, on a regular basis, compliance with loan covenants, environmental restrictions, and other legal requirements;

(c) receivables pledged by a borrower shall be diversified and not be unduly correlated with that borrower. Where there is material positive correlation, institutions shall take into account the attendant risks in the setting of margins for the collateral pool as a whole;

(d) institutions shall not use receivables from affiliates of a borrower, including subsidiaries and employees, as eligible credit protection;

(e) institution shall have in place a documented process for collecting receivable payments in distressed situations. Institutions shall have in place the requisite facilities for collection even when they normally rely on their borrowers for collections.

#### *Article 210*

##### **Requirements for other physical collateral**

Physical collateral other than immovable property collateral shall qualify as eligible collateral under the IRB Approach where all the following conditions are met:

(a) the collateral arrangement under which the physical collateral is provided to an institution **shall be legally effective and enforceable in all relevant jurisdictions** and shall enable that institution to realise the value of the collateral within a reasonable timeframe;

(b) with the sole exception of permissible first priority claims referred to in Article 209(2)(b), only first liens on, or charges over, collateral shall qualify as eligible collateral and an institution shall have priority over all other lenders to the realised proceeds of the collateral;

(c) institutions shall monitor the value of the collateral on a frequent basis and at least once every year. Institutions shall carry out more frequent monitoring where the market is subject to significant changes in conditions;

(d) the loan agreement shall include detailed descriptions of the collateral as well as detailed specifications of the manner and frequency of revaluation;

(e) institutions shall clearly document in internal credit policies and procedures available for examination the types of physical collateral they accept and the policies and practices they have in place in respect of the appropriate amount of each type of collateral relative to the exposure amount;

(f) institutions' credit policies with regard to the transaction structure shall address the following:

(i) appropriate collateral requirements relative to the exposure amount;

(ii) the ability to liquidate the collateral readily;

(iii) the ability to establish objectively a price or market value;

(iv) the frequency with which the value can readily be obtained, including a professional appraisal or valuation;

(v) the volatility or a proxy of the volatility of the value of the collateral.

(g) when conducting valuation and revaluation, institutions shall take fully into account any deterioration or obsolescence of the collateral, paying particular attention to the effects of the passage of time on fashion- or date-sensitive collateral;

(h) institutions shall have the right to physically inspect the collateral. They shall also have in place policies and procedures addressing their exercise of the right to physical inspection;

(i) the collateral taken as protection shall be adequately insured against the risk of damage and institutions shall have in place procedures to monitor this.

#### *Article 212*

##### **Requirements for other funded credit protection**

1. Cash on deposit with, or cash assimilated instruments held by, a third party institution shall be eligible for the treatment set out in Article 232(1), where all the following conditions are met:

(a) the borrower's claim against the third party institution is openly pledged or assigned to the lending institution and such pledge or assignment is **legally effective and enforceable in all relevant jurisdictions** and is unconditional and irrevocable;

(b) the third party institution is notified of the pledge or assignment;

(c) as a result of the notification, the third party institution is able to make payments solely to the lending institution or to other parties only with the lending institution's prior consent.

2. Life insurance policies pledged to the lending institution shall qualify as eligible collateral where all the following conditions are met:

(a) the life insurance policy is openly pledged or assigned to the lending institution;

(b) the company providing the life insurance is notified of the pledge or assignment and, as a result of the notification, may not pay amounts payable under the contract without the prior consent of the lending institution;

(c) the lending institution has the right to cancel the policy and receive the surrender value in the event of the default of the borrower;

(d) the lending institution is informed of any non-payments under the policy by the policy-holder;

(e) the credit protection is provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the institution shall ensure that the amount deriving from the insurance contract serves the institution as security until the end of the duration of the credit agreement;

(f) the pledge or assignment is **legally effective and enforceable in all jurisdictions** which are relevant at the time of the conclusion of the credit agreement;

(g) the surrender value is declared by the company providing the life insurance and is non-reducible;

(h) the surrender value is to be paid by the company providing the life insurance in a timely manner upon request;

(i) the surrender value shall not be requested without the prior consent of the institution;

(j) the company providing the life insurance is subject to Directive 2009/138/EC or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Union.

## Sub - Section 2

### **Unfunded credit protection and credit linked notes**

#### *Article 213*

##### **Requirements common to guarantees and credit derivatives**

1. Subject to Article 214(1), credit protection deriving from a guarantee or credit derivative shall qualify as eligible unfunded credit protection where all the following conditions are met:

(a) the credit protection is direct;

(b) the extent of the credit protection is clearly defined and incontrovertible;

(c) the credit protection contract does not contain any clause, the fulfilment of which is outside the direct control of the lender, that:

(i) would allow the protection provider to cancel the protection unilaterally;

(ii) would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure;

(iii) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due, or when the leasing contract has expired for the purposes of recognising guaranteed residual value under Articles 134(7) and 166(4);

(iv) could allow the maturity of the credit protection to be reduced by the protection provider;

(d) the credit protection contract is **legally effective and enforceable in all jurisdictions** which are relevant at the time of the conclusion of the credit agreement.

2. An institution shall demonstrate to competent authorities that it has in place systems to manage potential concentration of risk arising from its use of guarantees and credit derivatives. An institution shall be able to demonstrate to the satisfaction of the competent authorities how its strategy in respect of its use of credit derivatives and guarantees interacts with its management of its overall risk profile.

3. An institution shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of its unfunded credit protection under the law applicable to its interest in the credit protection.

An institution shall have conducted sufficient **legal review** confirming the enforceability of the unfunded credit protection in all relevant jurisdictions. It shall repeat such review as necessary to ensure continuing enforceability.

## Section 2

### **Recognition of significant risk transfer**

#### *Article 243*

##### **Traditional securitisation**

1. The originator institution of a traditional securitisation may exclude securitised exposures from the calculation of risk-weighted exposure amounts and expected loss amounts if either of the following conditions is fulfilled:

(a) significant credit risk associated with the securitised exposures is considered to have been transferred to third parties;

(b) the originator institution applies a 1 250 % risk weight to all securitisation positions it holds in this securitisation or deducts these securitisation positions from Common Equity Tier 1 items in accordance with Article 36(1)(k).

2. Significant credit risk shall be considered to have been transferred in the following cases:

(a) the risk-weighted exposure amounts of the mezzanine securitisation positions held by the originator institution in this securitisation do not exceed 50 % of the risk weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;

(b) where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1 250 % risk weight exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the originator institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1 250 % risk weight.

Where the possible reduction in risk weighted exposure amounts, which the originator institution would achieve by this securitisation is not justified by a commensurate transfer of credit risk to third parties, competent authorities may decide on a case-by-case basis that significant credit risk shall not be considered to have been transferred to third parties.

3. For the purposes of paragraph 2, mezzanine securitisation positions mean securitisation positions to which a risk weight lower than 1 250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation position in this securitisation to which either of the following is assigned in accordance with Section 4:

(a) in the case of a securitisation position subject to Section 3, Sub-section 3 a credit quality step 1;

(b) in the case of a securitisation position subject to points Section 3, Sub-section 4 a credit quality step 1 or 2.

4. As an alternative to paragraphs 2 and 3, competent authorities shall grant permission to originator institutions to consider significant credit risk as having been transferred where the originator institution is able to demonstrate, in every case of a securitisation, that the reduction of own funds requirements which the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties.

Permission shall be granted only where the institution meets all of the following conditions:

(a) the institution has appropriately risk-sensitive policies and methodologies in place to assess the transfer of risk;

(b) the institution has also recognised the transfer of credit risk to third parties in each case for purposes of the institution's internal risk management and its internal capital allocation.



5. In addition to the requirements set out in paragraphs 1 to 4, as applicable, all the following conditions shall be met:

- (a) the securitisation documentation reflects the economic substance of the transaction;
- (b) the securitised exposures are put beyond the reach of the originator institution and its creditors, including in bankruptcy and receivership. This shall be supported by the **opinion of qualified legal counsel**;
- (c) the securities issued do not represent payment obligations of the originator institution;
- (d) the originator institution does not maintain effective or indirect control over the transferred exposures. An originator shall be considered to have maintained effective control over the transferred exposures if it has the right to repurchase from the transferee the previously transferred exposures in order to realise their benefits or if it is obligated to re-assume transferred risk. The originator institution's retention of servicing rights or obligations in respect of the exposures shall not of itself constitute indirect control of the exposures;
- (e) the securitisation documentation meets all the following conditions:
  - (i) it does not contain clauses that other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator institution including but not limited to altering the underlying credit exposures or increasing the yield payable to investors in response to a deterioration in the credit quality of the securitised exposures;
  - (ii) it does not contain clauses that increase the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool;
  - (iii) it makes it clear, where applicable, that any purchase or repurchase of securitisation positions by the originator or sponsor beyond its contractual obligations is exceptional and may only be made at arms' lengths conditions;
- (f) where there is a clean-up call option, that option shall also meet the following conditions:
  - (i) it is exercisable at the discretion of the originator institution;
  - (ii) it may only be exercised when 10 % or less of the original value of the exposures securitised remains unamortised;
  - (iii) it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement.

6. The competent authorities shall keep EBA informed about the specific cases, referred to in paragraph 2, where the possible reduction in risk-weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties, and the use institutions make of paragraph 4. EBA shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines. EBA shall review Member States' implementation of those guidelines and provide advice to the Commission by 31 December 2017 on whether a binding technical standard is required.

#### *Article 244*

#### **Synthetic securitisation**

1. An originator institution of a synthetic securitisation may calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with Article 249, if either of the following is met:

- (a) significant credit risk is considered to have been transferred to third parties either through funded or unfunded credit protection;
- (b) the originator institution applies a 1 250 % risk weight to all securitisation positions it holds in this securitisation or deducts these securitisation positions from Common Equity Tier 1 items in accordance with Article 36(1)(k).

2. Significant credit risk shall be considered to have been transferred if either of the following conditions is met:

- (a) the risk-weighted exposure amounts of the mezzanine securitisation positions which are held by the originator institution in this securitisation do not exceed 50 % of the risk weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;

(b) where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1 250 % risk weight exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the originator institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1 250 % risk weight;

(c) where the possible reduction in risk weighted exposure amounts, which the originator institution would achieve by this securitisation, is not justified by a commensurate transfer of credit risk to third parties, competent authority may decide on a case- by-case basis that significant credit risk shall not be considered to have been transferred to third parties.

3. For the purposes of paragraph 2, mezzanine securitisation positions means securitisation positions to which a risk weight lower than 1 250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation positions in this securitisation to which either of the following is assigned in accordance with Section 4:

- (a) in the case of a securitisation position subject to Section 3, Sub-section 3 a credit quality step 1;
- (b) in the case of a securitisation position subject to Section 3, Sub-section 4 a credit quality step 1 or 2.

4. As an alternative to paragraphs 2 and 3, competent authorities shall grant permission to originator institutions to consider significant credit risk as having been transferred where the originator institution is able to demonstrate, in every case of a securitisation, that the reduction of own funds requirements which the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties.

Permission shall be granted only where the institution meets all of the following conditions:

(a) the institution has appropriately risk-sensitive policies and methodologies in place to assess the transfer of risk;

(b) the institution has also recognised the transfer of credit risk to third parties in each case for purposes of the institution's internal risk management and its internal capital allocation.

5. In addition to the requirements set out in paragraphs 1 to 4, as applicable, the transfer shall comply with the following conditions:

(a) the securitisation documentation reflects the economic substance of the transaction;

(b) the credit protection by which the credit risk is transferred complies with Article 247(2);

(c) the instruments used to transfer credit risk do not contain terms or conditions that:

(i) impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;

(ii) allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;

(iii) other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator institution;

(iv) increase the institution's cost of credit protection or the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool;

(d) an **opinion is obtained from qualified legal counsel** confirming the enforceability of the credit protection in all relevant jurisdictions;

(e) the securitisation documentation shall make clear, where applicable, that any purchase or repurchase of securitisation positions by the originator or sponsor beyond its contractual obligations may only be made at arms' lengths conditions;

(f) where there is a clean-up call option, that option meets all the following conditions:

(i) it is exercisable at the discretion of the originator institution;

(ii) it may only be exercised when 10 % or less of the original value of the exposures securitised remains unamortised;

(iii) it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement.



6. The competent authorities shall keep EBA informed about the specific cases, referred to in paragraph 2, where the possible reduction in risk-weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties, and the use institutions make of paragraph 4. EBA shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines. EBA shall review Member States' implementation of those guidelines and provide advice to the Commission by 31 December 2017 on whether a binding technical standard is required.

## Section 7

### Contractual netting

#### Article 295

##### Recognition of contractual netting as risk-reducing

Institutions may treat as risk reducing in accordance with Article 298 only the following types of contractual netting agreements where the netting agreement has been recognised by competent authorities in accordance with Article 296 and where the institution meets the requirements set out in Article 297:

- (a) bilateral contracts for novation between an institution and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that the novation fixes one single net amount each time it applies so as to create a single new contract that replaces all former contracts and all obligations between parties pursuant to those contracts and is binding on the parties;
- (b) other bilateral agreements between an institution and its counterparty;
- (c) contractual cross-product netting agreements for institutions that have received the approval to use the method set out in Section 6 for transactions falling under the scope of that method. Competent authorities shall report to EBA a list of the contractual cross-product netting agreements approved.

Netting across transactions entered into by different legal entities of a group shall not be recognised for the purposes of calculating the own funds requirements.

#### Article 296

##### Recognition of contractual netting agreements

1. Competent authorities shall recognise a contractual netting agreement only where the conditions in paragraph 2 and, where relevant, 3 are fulfilled.
2. The following conditions shall be fulfilled by all contractual netting agreements used by an institution for the purposes of determining exposure value in this Part:
  - (a) the institution has concluded a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of default by the counterparty it would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;
  - (b) the institution has made available to the competent authorities written and reasoned **legal opinions** to the effect that, in the event of a legal challenge of the netting agreement, the institution's claims and obligations would not exceed those referred to in point (a). The **legal opinion** shall refer to the applicable law:
    - (i) the jurisdiction in which the counterparty is incorporated;
    - (ii) if a branch of an undertaking is involved, which is located in a country other than that where the undertaking is incorporated, the jurisdiction in which the branch is located;
    - (iii) the jurisdiction whose law governs the individual transactions included in the netting agreement;
    - (iv) the jurisdiction whose law governs any contract or agreement necessary to effect the contractual netting;

(c) credit risk to each counterparty is aggregated to arrive at a single legal exposure across transactions with each counterparty. This aggregation shall be factored into credit limit purposes and internal capital purposes;

(d) the contract shall not contain any clause which, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party, even if the defaulting party is a net creditor (i.e. walk away clause).

If any of the competent authorities are not satisfied that the contractual netting is legally valid and enforceable under the law of each of the jurisdictions referred to in point (b) the contractual netting agreement shall not be recognised as risk-reducing for either of the counterparties. Competent authorities shall inform each other accordingly.

3. The **legal opinions** referred to in point (b) may be drawn up by reference to types of contractual netting. The following additional conditions shall be fulfilled by contractual cross-product netting agreements:

(a) the net sum referred to in point (a) of paragraph 2 is the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and negative mark-to-market value of the individual transactions (the 'Cross-Product Net Amount');

(b) the **legal opinions** referred to in point (b) of paragraph 2 shall address the validity and enforceability of the entire contractual cross-product netting agreement under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreement.

#### *Article 297*

##### **Obligations of institutions**

1. An institution shall establish and maintain procedures to ensure that the legal validity and enforceability of its contractual netting is reviewed in the light of changes in the law of relevant jurisdictions referred to in Article 296(2)(b).

2. The institution shall maintain all required documentation relating to its contractual netting in its files.

3. The institution shall factor the effects of netting into its measurement of each counterparty's aggregate credit risk exposure and the institution shall manage its CCR on the basis of those effects of that measurement.

4. In the case of contractual cross-product netting agreements referred to in Article 295, the institution shall maintain procedures under Article 296(2)(c) to verify that any transaction which is to be included in a netting set is covered by a **legal opinion** referred to in Article 296(2)(b).

Taking into account the contractual cross-product netting agreement, the institution shall continue to comply with the requirements for the recognition of bilateral netting and the requirements of Chapter 4 for the recognition of credit risk mitigation, as applicable, with respect to each included individual bilateral master agreement and transaction.

#### *Article 305*

##### **Treatment of clients' exposures**

1. Where an institution is a client, it shall calculate the own funds requirements for its CCP-related transactions with its clearing member in accordance with Sections 1 to 8 of this Chapter and with Title VI of Part Three, as applicable.

2. Without prejudice to the approach specified in paragraph 1, where an institution is a client, it may calculate the own funds requirements for its trade exposures for CCP-related transactions with its clearing member in accordance with Article 306 provided that all the following conditions are met:

(a) the positions and assets of that institution related to those transactions are distinguished and segregated, at the level of both the clearing member and the CCP, from the positions and assets of both the clearing member and the other clients of that clearing member and as a result of that distinction and segregation those positions and assets are bankruptcy remote in the event of the default or insolvency of the clearing member or one or more of its other clients;

(b) laws, regulations, rules and contractual arrangements applicable to or binding that institution or the CCP facilitate the transfer of the client's positions relating to those contracts and transactions and of

the corresponding collateral to another clearing member within the applicable margin period of risk in the event of default or insolvency of the original clearing member. In such circumstance, the client's positions and the collateral shall be transferred at market value unless the client requests to close out the position at market value;

(c) the institution has available an independent, written and reasoned **legal opinion** that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the client would bear no losses on account of the insolvency of its clearing member or of any of its clearing member's clients under the laws of the jurisdiction of the institution, its clearing member and the CCP, the law governing the transactions and contracts the institution clears through the CCP, the law governing the collateral, and the law governing any contract or agreement necessary to meet the condition in point (b);

(d) the CCP is a Q CCP .

3. Without prejudice to the conditions specified in paragraph 2, where an institution that is a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default, but all the other conditions set out in paragraph 2 are met, the client may calculate the own funds requirements for its trade exposures for CCP-related transactions with its clearing member in accordance with Article 306, subject to replacing the 2 % risk weight in paragraph 1(a) of that Article with a 4 % risk weight.

4. Where an institution that is a client accesses the services of a CCP through indirect clearing arrangements, in accordance with Article 4(3) of Regulation (EU) No 648/2012, that institution may apply the treatment set out in paragraph 2 or 3 only where the conditions in each paragraph are met at every level of the chain of intermediaries

#### **CRD IV**

##### *Article 80*

#### **Residual risk**

Competent authorities shall ensure that the risk that recognised credit risk mitigation techniques used by institutions prove less effective than expected is addressed and controlled including by means of written policies and procedures.

##### *Article 81*

#### **Concentration risk**

Competent authorities shall ensure that the concentration risk arising from exposures to each counterparty, including central counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity, the application of **credit risk mitigation techniques**, and including in particular risks associated with large indirect credit exposures such as a single collateral issuer, is addressed and controlled including by means of written policies and procedures.

### **Section III**

#### **Supervisory review and evaluation process**

##### *Article 98*

#### **Technical criteria for the supervisory review and evaluation**

1. In addition to credit, market and operational risks, the review and evaluation performed by competent authorities pursuant to Article 97 shall include at least:

(a) the results of the stress test carried out in accordance with Article 177 of Regulation (EU) No 575/2013 by institutions applying an internal ratings based approach;

(b) the exposure to and management of concentration risk by institutions, including their compliance with the requirements set out in Part Four of Regulation (EU) No 575/2013 and Article 81 of this Directive;

(c) the robustness, suitability and manner of application of the policies and procedures implemented by institutions for the management of the residual risk associated with the use of recognised **credit risk mitigation techniques**;

(d) the extent to which the own funds held by an institution in respect of assets which it has securitised are adequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved;

(e) the exposure to, measurement and management of liquidity risk by institutions, including the development of alternative scenario analyses, the management of risk mitigants (in particular the level, composition and quality of liquidity buffers) and effective contingency plans;

(f) the impact of diversification effects and how such effects are factored into the risk measurement system;

(g) the results of stress tests carried out by institutions using an internal model to calculate market risk own funds requirements under Part Three, Title IV, Chapter 5 of Regulation (EU) No 575/2013;

(h) the geographical location of institutions' exposures;

(i) the business model of the institution;

(j) the assessment of systemic risk, in accordance with the criteria set out in Article 97.

2. For the purposes of point (e) of paragraph 1, the competent authorities shall regularly carry out a comprehensive assessment of the overall liquidity risk management by institutions and promote the development of sound internal methodologies. While conducting those reviews, the competent authorities shall have regard to the role played by institutions in the financial markets. The competent authorities in one Member State shall duly consider the potential impact of their decisions on the stability of the financial system in all other Member States concerned.

3. Competent authorities shall monitor whether an institution has provided implicit support to a securitisation. If an institution is found to have provided implicit support on more than one occasion the competent authority shall take appropriate measures reflective of the increased expectation that it will provide future support to its securitisation thus failing to achieve a significant transfer of risk.

4. For the purposes of the determination to be made under Article 97(3) of this Directive, competent authorities shall consider whether the valuation adjustments taken for positions or portfolios in the trading book, as set out in Article 105 of Regulation (EU) No 575/2013, enable the institution to sell or hedge out its positions within a short period without incurring material losses under normal market conditions.

5. The review and evaluation performed by competent authorities shall include the exposure of institutions to the interest rate risk arising from non-trading activities. Measures shall be required at least in the case of institutions whose economic value declines by more than 20 % of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points or such change as defined in the EBA guidelines.

6. The review and evaluation performed by competent authorities shall include the exposure of institutions to the risk of excessive leverage as reflected by indicators of excessive leverage, including the leverage ratio determined in accordance with Article 429 of Regulation (EU) No 575/2013. In determining the adequacy of the leverage ratio of institutions and of the arrangements, strategies, processes and mechanisms implemented by institutions to manage the risk of excessive leverage, competent authorities shall take into account the business model of those institutions.

7. The review and evaluation conducted by competent authorities shall include governance arrangements of institutions, their corporate culture and values, and the ability of members of the management body to perform their duties. In conducting that review and evaluation, competent authorities shall, at least, have access to agendas and supporting documents for meetings of the management body and its committees, and the results of the internal or external evaluation of performance of the management body.