EUROPEAN
COMMISSION

Brussels, 28.5.2020
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COMMISSION DELEGATED REGULATION (EU) …/...

of 28.5.2020

amending Delegated Regulation (EU) 2016/101 of 26 October 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for prudent valuation under Article 105(14) of Regulation (EU) No 575/2013

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 105(14) of Regulation (EU) No 575/2013[1] ('the Regulation') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010, delegated acts specifying the requirements for prudent valuation, to which institutions should be subject.

The EBA proposed on 22 April 2020[2] to amend the standards on prudent valuation in order to mitigate the impact of exceptional volatility triggered by the COVID-19 pandemic on the prudential requirements for market risk. In accordance with Article 10(1) of Regulation (EU) No 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

This delegated act introduces a temporary adjustment aimed at mitigating increases in aggregated amounts of additional valuation adjustments ('AVA') under the prudent valuation framework, and their excessive effect on amounts deducted from banks' own funds as a result of the current period of extreme market volatility. Article 105 of the Regulation requires institutions to achieve an appropriate degree of certainty in valuing their fair-valued financial instruments for prudential purposes and to formally consider valuation adjustments to this end. Article 34 of the Regulation requires institutions to deduct from their Common Equity Tier 1 (CET1) capital the AVAs calculated in accordance with Article 105 of the Regulation.

The technical details determining the conditions according to which the requirements of Article 105 are to be applied are further specified in Commission Delegated Regulation (EU) 2016/101 (Regulatory Technical Standards or 'RTS' on prudent valuation). The RTS provide two approaches for the calculation of additional valuation adjustments. Under the most risk-sensitive approach - the so-called core approach - institutions have to calculate a number of AVAs for the different types of valuation adjustments referred to in paragraphs 10 and 11 of Article 105. Individual AVAs are then aggregated into a total AVA amount, which is deducted from CET1 in accordance with Article 34.

The calculation of individual AVAs under the core approach relies on current market conditions and is performed quarterly, for each reporting period. Volatile market conditions tend to translate into greater uncertainty specific to fair-valued instruments, leading to significant increases in total AVAs, and hence a higher deduction from CET1 capital. This could incentivise financial institutions to deleverage (i.e. sell financial assets) or to curtail market activities (e.g. hedging services for its clients).

Therefore, a temporary simple adjustment to the RTS on prudent valuation is proposed. This adjustment will increase the aggregation factor used to calculate the total AVA amount under the core approach from 50% to 66%. The increase is temporary (it will be applicable until 31 December 2020) and is meant to allow institutions to weather out the current extreme market

[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p.1).

[2] https://eba.europa.eu/eba-provides-further-guidance-use-flexibility-relation-covid-19-and-calls-heightened-attention-risks

volatility. Increasing the aggregation factor would reduce the total AVAs amount, hence reducing the amount deducted from institutions' CET1 capital.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

This Delegated Regulation will impact institutions using the core approach of the prudent valuation requirements set out in Delegated Regulation (EU) 2016/101 to calculate the AVAs of fair value instruments.

Due to the urgency caused by the unprecedented difficulties of the COVID-19 pandemic, which requires the speedy update of the rules to provide comfort to the institutions potentially affected by the crisis in their calculation of AVAs, the EBA decided not to carry out public consultations or cost-benefit analysis. Further, since actions must be taken urgently in accordance with the above and consultation was impossible, the EBA informed the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

In light of the systemic shock caused by the COVID-19 pandemic and the decision by public authorities, in the Union and across the globe, to halt large parts of economic activity in their efforts to curb the evolution of the pandemics, this draft Delegated Regulation amends Delegated Regulation (EU) 2016/101 by providing an aggregation factor of 66% for this specific period of extreme volatility in market prices and systemic shock due to the COVID-19, in place of the aggregation factor to be used under normal market conditions, set at 50%. As it is expected that the extreme market volatility due to the COVID-19 pandemic will recede with the subsiding of the pandemic within the next months, such provision should be of a transitional nature and should apply until 31 December 2020.

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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[3], and in particular the third subparagraph of Article 105(14) thereof,

Whereas:

(1) Article 9(5), Article 10(6) and Article 11(3) of Commission Delegated Regulation (EU) 2016/101[4] provide that, with regard to institutions that calculate additional valuation adjustments (AVAs) under the core approach set out in that Regulation, individual AVAs related to market price uncertainty, close-out costs and model risk are to be determined with reference to a 90% level of certainty based on the applicable market conditions at the time of the calculation. That Regulation also specifies an aggregation approach for the calculation of the total category level AVAs based on those individual AVAs, which takes account of overlaps among individual AVAs that occur in the aggregation of those categories of AVAs.

(2) The expansion of the COVID-19 pandemic has triggered levels of extreme volatility throughout financial markets worldwide, affecting multiple asset classes. This has generated exceptional increases in asset price dispersion and bid-offer spreads. It is therefore expected that individual AVAs computed at the level of valuation exposures will significantly increase in comparison with their levels in normal times.

(3) The adjustment of individual AVAs to new market conditions is a normal process. It is to be expected, however, that due to the COVID-19 pandemic and the decisions of public authorities to halt economic activity in a large number of areas, the aggregation of significantly increased individual AVAs will have a disproportionate impact on aggregated AVA amounts. The rules for prudent valuation should therefore be revised so that, in addition to providing for an aggregation factor to be used under normal market conditions, they also provide that institutions should apply a higher

[3] OJ L 176, 27.6.2013, p. 1.

[4] Commission Delegated Regulation (EU) 2016/101 of 26 October 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for prudent valuation under Article 105(14) (OJ L 21, 28.1.2016, p. 54).

aggregation factor for this specific period of extreme volatility in market prices and systemic shock due to the COVID-19 pandemic.

(4) It is to be expected that the extreme market volatility arising as a result of the COVID-19 pandemic will decrease with the subsiding of the pandemic expected in the next months. The higher aggregation factor should therefore only apply for the expected duration of that extreme market volatility combined with systemic shock, which is currently assessed to last until 31 December 2020.

(5) Delegated Regulation (EU) 2016/101 should therefore be amended accordingly.

(6) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission. Due to the urgency caused by the COVID-19 pandemic, the European Banking Authority has deemed that the carrying out of a public consultation and cost-benefit analysis would be dispoportionate. However, the European Banking Authority informed the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[5].

(7) In order to react swiftly to the consequences of the COVID-19 pandemic, this Regulation should enter into force on the day following that of its publication,

HAS ADOPTED THIS REGULATION:

Article 1

The Annex to Delegated Regulation (EU) 2016/101 is replaced by the text in the Annex to this Regulation.

Article 2

This Regulation shall enter into force on the 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, 28.5.2020

For the Commission
The President
Ursula VON DER LEYEN

[5] 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).