Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State (Text with EEA relevance)

REGULATION (EU) 2017/2395 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 12 December 2017

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(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank[(1)],

Having regard to the opinion of the European Economic and Social Committee[(2)],

Acting in accordance with the ordinary legislative procedure[(3)],

Whereas:

(1) On 24 July 2014, the International Accounting Standards Board published International Financial Reporting Standard (IFRS) 9 Financial Instruments (IFRS 9). IFRS 9 aims to improve the financial reporting of financial instruments by addressing concerns that arose in that area during the financial crisis. In particular, IFRS 9 responds to the G20's call to move to a more forward-looking model for the recognition of expected credit losses on financial assets. In relation to the recognition of expected credit losses on financial assets it replaces International Accounting Standard (IAS) 39.

(2) The Commission adopted IFRS 9 through Commission Regulation (EU) 2016/2067[(4)]. In accordance with that Regulation, credit institutions and investment firms ('institutions') that use IFRS to prepare their financial statements are required to apply IFRS 9 as of the starting date of their first financial year starting on or after 1 January 2018.

(3) The application of IFRS 9 may lead to a sudden significant increase in expected credit loss provisions and consequently to a sudden decrease in institutions' Common

Equity Tier 1 capital. While the Basel Committee on Banking Supervision is currently considering the longer-term regulatory treatment of expected credit loss provisions, transitional arrangements should be introduced in Regulation (EU) No 575/2013 of the European Parliament and of the Council[(5)] to mitigate that potentially significant negative impact on Common Equity Tier 1 capital arising from expected credit loss accounting.

(4) In its resolution of 6 October 2016 on International Financial Reporting Standards: IFRS 9[(6)], the European Parliament called for a progressive phase-in regime that would mitigate the impact of the new impairment model of IFRS 9.

(5) Where an institution's opening balance sheet on the day that it first applies IFRS 9 reflects a decrease in Common Equity Tier 1 capital as a result of increased expected credit loss provisions, including the loss allowance for lifetime expected credit losses for financial assets that are credit-impaired, as defined in Appendix A to IFRS 9 as set out in the Annex to Commission Regulation (EC) No 1126/2008[(7)] ('Annex relating to IFRS 9'), compared to the closing balance sheet on the previous day, the institution should be allowed to include in its Common Equity Tier 1 capital a portion of the increased expected credit loss provisions for a transitional period. That transitional period should have a maximum duration of 5 years and should start in 2018. The portion of expected credit loss provisions that can be included in Common Equity Tier 1 capital should decrease over time down to zero to ensure the full implementation of IFRS 9 on the day immediately after the end of the transitional period. The impact of the expected credit loss provisions on Common Equity Tier 1 capital should not be fully neutralised during the transitional period.

(6) Institutions should decide whether to apply those transitional arrangements and inform the competent authority accordingly. During the transitional period, an institution should have the possibility to reverse once its initial decision, subject to the prior permission of the competent authority which should ensure that such decision is not motivated by considerations of regulatory arbitrage.

(7) As expected credit loss provisions incurred after the day that an institution first applies IFRS 9 could rise unexpectedly due to a worsening macroeconomic outlook, institutions should be granted additional relief in such cases.

(8) Institutions that decide to apply transitional arrangements should be required to adjust the calculation of regulatory items which are directly affected by expected credit loss provisions to ensure that they do not receive inappropriate capital relief. For example, the specific credit risk adjustments by which the exposure value is reduced under the Standardised Approach for credit risk should be reduced by a factor which has the effect of increasing the exposure value. This would ensure that an institution would not benefit from both an increase in its Common Equity Tier 1 capital due to transitional arrangements as well as a reduced exposure value.

(9) Institutions that decide to apply the IFRS 9 transitional arrangements specified in this Regulation should publicly disclose their own funds, capital ratios and leverage ratios both with and without the application of those arrangements in order to enable the public to determine the impact of those arrangements.

(10) It is also appropriate to provide for transitional arrangements for the exemption from the large exposure limit available for exposures to certain public sector debt of Member States denominated in the domestic currency of any Member State. The transitional period should have a duration of 3 years starting from 1 January 2018 for exposures of this type incurred on or after 12 December 2017, whilst exposures of this type incurred before that date should be grandfathered and should continue to benefit from the large exposures exemption.

(11) In order to enable the transitional arrangements provided for in this Regulation to be applied from 1 January 2018, this Regulation should enter into force on the day following that of its publication in the *Official Journal of the European Union*.

(12) Regulation (EU) No 575/2013 should therefore be amended accordingly,

HAVE ADOPTED THIS REGULATION:

Article 1

Regulation (EU) No 575/2013 is amended as follows:

(1) the following Article is inserted:

Article 473a

Introduction of IFRS 9

1 By way of derogation from Article 50 and until the end of the transitional period set out in paragraph 6 of this Article, the following may include in their Common Equity Tier 1 capital the amount calculated in accordance with this paragraph:

a institutions that prepare their accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2) of Regulation (EC) No 1606/2002;

b institutions that, pursuant to Article 24(2) of this Regulation, effect the valuation of assets and off-balance sheet items and the determination of own funds in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2) of Regulation (EC) No 1606/2002;

c institutions that effect the valuation of assets and off-balance sheet items in conformity with accounting standards under Directive 86/635/EEC and that use an expected credit loss model that is the same as the one used in international accounting standards adopted in accordance with the procedure laid down in Article 6(2) of Regulation (EC) No 1606/2002.

The amount referred to in the first subparagraph shall be calculated as the sum of the following:

a for exposures which are subject to risk weighting in accordance with Chapter 2 of Title II of Part Three, the amount (AB_{SA}) calculated in accordance with the following formula:

$$\mathbf{AB_{SA}} = (A_{2,SA} + A_{4,SA} - t) \cdot \mathbf{f}$$

where:

Changes to legislation: *There are currently no known outstanding effects for the Regulation (EU) 2017/2395 of the European Parliament and of the Council. (See end of Document for details)*

$A_{2,SA}$	=	the amount calculated in accordance with paragraph 2;
$A_{4,SA}$	=	the amount calculated in accordance with paragraph 4 based on the amounts calculated in accordance with paragraph 3;
f	=	the applicable factor laid down in paragraph 6;
t	=	increase of Common Equity Tier 1 capital that is due to tax deductibility of the amounts $A_{2,SA}$ and $A_{4,SA}$;

b for exposures which are subject to risk weighting in accordance with Chapter 3 of Title II of Part Three, the amount (AB_{IRB}) calculated in accordance with the following formula:

$$AB_{IRB} = (A_{2,IRB} + A_{4,IRB} - t) \cdot f$$

where:

$A_{2,IRB}$	=	the amount calculated in accordance with paragraph 2 adjusted in accordance with point (a) of paragraph 5;
$A_{4,IRB}$	=	the amount calculated in accordance with paragraph 4 based on the amounts calculated in accordance with paragraph 3 which are adjusted in accordance with points (b) and (c) of paragraph 5;
f	=	the applicable factor laid down in paragraph 6;
t	=	increase of Common Equity Tier 1 capital that is due to tax deductibility of the amounts $A_{2,IRB}$ and $A_{4,IRB}$.

2 Institutions shall calculate the amounts $A_{2,SA}$ and $A_{2,IRB}$ referred to, respectively, in points (a) and (b) of the second subparagraph of paragraph 1 as the greater of the amounts referred to in points (a) and (b) of this paragraph separately for their exposures which are subject to risk weighting in accordance with Chapter 2 of Title II of Part Three and for their exposures which are subject to risk weighting in accordance with Chapter 3 of Title II of Part Three:

a zero;

b the amount calculated in accordance with point (i) reduced by the amount calculated in accordance with point (ii):

(i) the sum of the 12-month expected credit losses determined in accordance with paragraph 5.5.5 of IFRS 9 as set out in the Annex to Commission Regulation (EC) No 1126/2008 (“Annex relating to IFRS 9”) and the amount of the loss allowance for lifetime expected credit losses determined in accordance with paragraph 5.5.3 of the Annex relating to IFRS 9 as of 1 January 2018 or on the date of initial application of IFRS 9;

(ii) the total amount of impairment losses on financial assets classified as loans and receivables, held-to-maturity investments and available-for-sale financial assets, as defined in paragraph 9 of IAS

39, other than equity instruments and units or shares in collective investment undertakings, determined in accordance with paragraphs 63, 64, 65, 67, 68 and 70 of IAS 39 as set out in the Annex to Regulation (EC) No 1126/2008 as of 31 December 2017 or the day before the date of initial application of IFRS 9.

3 Institutions shall calculate the amount by which the amount referred to in point (a) exceeds the amount referred to in point (b) separately for their exposures which are subject to risk weighting in accordance with Chapter 2 of Title II of Part Three and for their exposures which are subject to risk weighting in accordance with Chapter 3 of Title II of Part Three:

a the sum of the 12-month expected credit losses determined in accordance with paragraph 5.5.5 of the Annex relating to IFRS 9 and the amount of the loss allowance for lifetime expected credit losses determined in accordance with paragraph 5.5.3 of the Annex relating to IFRS 9 excluding the loss allowance for lifetime expected credit losses for financial assets that are credit-impaired as defined in Appendix A to the Annex relating to IFRS 9 as of the reporting date;

b the sum of the 12-month expected credit losses determined in accordance with paragraph 5.5.5 of the Annex relating to IFRS 9 and the amount of the loss allowance for lifetime expected credit losses determined in accordance with paragraph 5.5.3 of the Annex relating to IFRS 9 excluding the loss allowance for lifetime expected credit losses for financial assets that are credit-impaired as defined in Appendix A to the Annex relating to IFRS 9 as of 1 January 2018 or on the date of initial application of IFRS 9.

4 For exposures which are subject to risk weighting in accordance with Chapter 2 of Title II of Part Three, where the amount specified in accordance with point (a) of paragraph 3 exceeds the amount specified in point (b) of paragraph 3, institutions shall set $A_{4,SA}$ as equal to the difference between those amounts, otherwise they shall set $A_{4,SA}$ as equal to zero.

For exposures which are subject to risk weighting in accordance with Chapter 3 of Title II of Part Three, where the amount specified in accordance with point (a) of paragraph 3, after applying point (b) of paragraph 5, exceeds the amount for these exposures as specified in point (b) of paragraph 3, after applying point (c) of paragraph 5, institutions shall set $A_{4,IRB}$ as equal to the difference between those amounts, otherwise they shall set $A_{4,IRB}$ as equal to zero.

5 For exposures which are subject to risk weighting in accordance with Chapter 3 of Title II of Part Three, institutions shall apply paragraphs 2 to 4 as follows:

a for the calculation of $A_{2,IRB}$ institutions shall reduce each of the amounts calculated in accordance with points (b)(i) and (ii) of paragraph 2 of this Article by the sum of expected loss amounts calculated in accordance with Article 158(5), (6) and (10) as of 31 December 2017 or the day before the date of initial application of IFRS 9. Where for the amount referred to in point (b)(i) of paragraph 2 of this Article the calculation results in a negative number, the institution shall set the value of that amount as equal to zero. Where for the amount referred to in point (b)(ii) of paragraph 2 of this Article the calculation results in a negative number, the institution shall set the value of that amount as equal to zero;

b institutions shall replace the amount calculated in accordance with point (a) of paragraph 3 of this Article by the sum of the 12-month expected credit losses