Changes to legislation: *There are outstanding changes not yet made to Commission Delegated Regulation (EU) No 1187/2014. Any changes that have already been made to the legislation appear in the content and are referenced with annotations. (See end of Document for details)EUR 2014 No. 1187 may be subject to amendment by EU Exit Instruments made by both the Prudential Regulation Authority and the Financial Conduct Authority under powers set out in The Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (S.I. 2018/1115), regs. 2, 3, Sch. Pt. 4. These amendments are not currently available on legislation.gov.uk. Details of relevant amending instruments can be found on their website/s. (See end of Document for details) View outstanding changes*

Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) No 1187/2014

of 2 October 2014

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets

(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 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[(1)], and in particular the third subparagraph of Article 390(8) thereof,

Whereas:

(1) In order to identify the overall exposure to a particular obligor that results from the institution's exposures to a transaction with underlying assets, the exposure value should be firstly identified separately for each of these exposures. The total exposure value should then be determined by the aggregate of these exposures, but should not be larger than the exposure value of the exposure formed by the underlying asset itself.

(2) Where exposures of other investors rank *pari passu* with the institution's exposure, the exposure value of the institution's exposure to an underlying asset should reflect the pro-rata distribution of losses amongst the exposures that rank *pari passu*. This results from the fact that if a default event has occurred for an underlying asset, losses are always distributed amongst the exposures that rank *pari passu* according to the pro-rata ratio of each of these exposures and the maximum loss to be suffered by the institution in case of a total loss on an underlying asset is limited to the portion according to the ratio of the institution's exposure to the total of all the exposures that rank *pari passu*.

(3) A distinction should be made between transactions where all investors rank *pari passu* such as collective investment undertakings, and other transactions, such as securitisations, which can involve tranching where exposures can rank differently in seniority. For the former, the resulting exposure to an underlying asset is solely dependent on the pro-rata ratio of the investor's exposure in relation to the exposures of all investors. For the latter, losses are attributed first to certain tranches depending

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on their seniority and then, in case of more than one investor into the same tranche, amongst the investors on a pro rata basis. All tranches in a securitisation should be treated equally as, in a worst case scenario, subordinated tranches may disappear very quickly. In particular, the maximum loss to be suffered by all investors in a certain tranche in case of a total loss on an underlying asset should be recognised since no mitigation should be recognised from subordinated tranches. The institution's exposure to an underlying asset of a transaction should not exceed the total exposure value of this tranche (since the loss for an investor in a given tranche that stems from the default of an underlying asset can never be higher than the total exposure value of the tranche) and the exposure value of the exposure formed by the underlying asset (since the institution can never lose more than the amount of the underlying asset). This limitation of maximum loss should be reflected by using the lower of the two exposure values and then applying the procedure for recognising the pro-rata distribution of losses amongst all exposures that rank *pari passu* in this tranche, in case of more than one investor in this tranche.

(4) Although institutions are expected to identify all obligors of underlying assets of transactions in which they invest, there may be cases where this would create unjustifiable costs for institutions or where circumstances prevent institutions from identifying particular obligors As such, where an exposure to an underlying asset is sufficiently small to only immaterially contribute to the overall exposure to a certain client or group of connected clients, it should be sufficient to assign this exposure to the transaction as a separate client. The total of such exposures to underlying assets of the same transaction should then still be limited by the large exposures limit for this transaction. Immateriality of the contribution of an underlying asset to the overall exposure should be assumed where at least 100 exposures to underlying assets of a transaction are needed to reach the limit of 25 % of the institution's eligible capital. This would require that the exposure value does not exceed 0,25 % of the institution's eligible capital.

(5) In order to prevent an unlimited overall exposure resulting from information deficiencies, it would be necessary to assign exposures — for which the exposure value exceeds 0,25 % of the institution's eligible capital and for which information on the obligor is missing — to a hypothetical client (unknown client) to which the 25 % large exposures' limit should apply.

(6) Where an institution is not able to distinguish between the underlying assets of a transaction in terms of their amount, there is a risk that the underlying assets of the transaction relate to the same obligor or group of connected clients. In this case, in order to mitigate this risk, the institution should be required to assess the materiality of the total value of its exposures to the transaction before being able to assign it to the transaction as a separate client instead of the 'unknown client'.

(7) The structure of a transaction should not constitute an additional exposure where the circumstances of the transaction ensure that losses on an exposure to this transaction can only result from default events of underlying assets. An additional exposure should be recognised where the transaction involves a payment obligation of a certain person in addition to, or at least in advance of, the cash flows from the underlying assets,

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given that investors could suffer additional losses in the event of default of this person although no default event has occurred for an underlying asset. An additional exposure should also be recognised where the circumstances of the transaction enable cash flows to be redirected to a person who is not entitled to receive them as investors could suffer additional losses, although no default event for an underlying asset has occurred. No additional exposure should be recognised for undertakings for collective investment in transferable securities (UCITS) as referred to in Directive 2009/65/EC of the European Parliament and of the Council[(2)], given that cash flows cannot be redirected to a person who is not entitled under the transaction to receive these cash flows. This should also be assumed for entities that are subject to equivalent requirements pursuant to Union legislative acts or to legislation of a third country.

(8) The existence and value of exposures to a client or group of connected clients resulting from exposures to transactions do not depend on whether the exposures to transactions are assigned to the trading book or the non-trading book. Therefore, the conditions and methodologies to be used for identifying exposures to transactions with underlying assets should be the same, irrespective of whether these exposures are assigned to the trading book or the non-trading book of the institution.

(9) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority (EBA) to the Commission.

(10) The EBA 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 of the European Parliament and of the Council[(3)],

HAS ADOPTED THIS REGULATION:

Article 1

Subject matter

This Regulation specifies the conditions and methodologies used to determine the overall exposure of an institution to a client or a group of connected clients in respect of exposures through transactions with underlying assets and the conditions under which the structure of transactions with underlying assets does not constitute an additional exposure.

Article 2

Definitions

For the purposes of this Regulation the following definitions shall apply:

(a) 'transactions' mean, transactions referred to in points (m) and (o) of Article 112 of Regulation (EU) No 575/2013 and other transactions where there is an exposure to underlying assets;

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(b) 'unknown client' means a single hypothetical client to which the institution assigns all exposures for which it has not identified the obligor, provided that Article 6(2)(a) and (b) and Article 6(3)(a) of this Regulation are not applicable.

Article 3

Identification of exposures resulting from transactions

1 An institution shall determine the contribution to the overall exposure to a certain client or group of connected clients that results from a certain transaction in accordance with the methodology set out in Articles 4, 5 and 6.

The institution shall determine separately for each of the underlying assets its exposure to this underlying asset in accordance with Article 5.

2 An institution shall assess whether a certain transaction constitutes an additional exposure in accordance with Article 7.

Article 4

Underlying exposures to transactions which themselves have underlying assets

1 When assessing the underlying exposures of a transaction (transaction A) which itself has an underlying exposure to another transaction (transaction B) for the purpose of Articles 5 and 6, an institution shall treat the exposure to transaction B as replaced with the exposures underlying transaction B.

2 Paragraph 1 shall apply as long as the underlying exposures are exposures to transactions with underlying assets.

Article 5

Calculation of the exposure value

1 The exposure of an institution to an underlying asset of a transaction is the lower of the following:

a the exposure value of the exposure arising from the underlying asset;

b the total exposure value of the institution's exposures to the underlying asset resulting from all exposures of the institution to the transaction.

2 For each exposure of an institution to a transaction, the exposure value of the resulting exposure to an underlying asset shall be determined as follows:

a if the exposures of all investors in this transaction rank *pari passu*, the exposure value of the resulting exposure to an underlying asset shall be the pro rata ratio for the institution's exposure to the transaction multiplied by the exposure value of the exposure formed by the underlying asset;

b in cases other than those referred to point (a) the exposure value of the resulting exposure to an underlying asset shall be the pro rata ratio for the institution's exposure to the transaction multiplied by the lower of:

(i) the exposure value of the exposure formed by the underlying asset;