Changes to legislation: *There are outstanding changes not yet made to Commission Delegated Regulation (EU) No 528/2014. 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. 528 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 528/2014 of 12 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for non-delta risk of options in the standardised market risk approach (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) No 528/2014

of 12 March 2014

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for non-delta risk of options in the standardised market risk 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 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 329(3), the third subparagraph of Article 352(6) and the third subparagraph of Article 358(4) thereof.

Whereas:

(1) In light of the mandate contained in Regulation (EU) No 575/2013 to develop a range of methods to reflect other risks, apart from delta risk, in the own funds requirements of institutions, 'in a manner proportionate to the scale and complexity of institutions' activities in options and warrants', it is appropriate to design approaches with different levels of sophistication and risk sensitivity which may be suitable for different profiles of institutions. It is, therefore, appropriate to provide for the following three approaches in order of increasing complexity to measure non-delta risks of options and warrants: (i) the simplified approach; (ii) the delta-plus approach; and (iii) the scenario approach. This framework based on three approaches largely implements the non-delta-risk framework provided for by the Basel Committee for Banking Supervision (BCBS), with the necessary adjustments to take into account Regulation (EU) No 575/2013. That has the added benefit of ensuring consistency between Union rules and internationally agreed minimum standards.

(2) Given it is necessary to provide institutions that apply the delta-plus approach the possibility of treating non-continuous options in a more risk-sensitive way, institutions should be able to combine the approaches provided for the measurement of the risk of options and warrants under certain conditions, not only within groups but also within single legal entities. Nevertheless, in order to avoid the possibility of selective application of approaches by institutions with the view to minimizing their own funds requirements, the combination of approaches on an individual basis should only be

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allowed on the condition that institutions specify the scope of application of each approach before beginning to use it, so as to apply it consistently over time.

(3) Non-delta risks related to options and warrants can include, but are not limited to, risks arising from changes in the instrument's gamma referred to as 'gamma risk' or 'convexity risk' as set out in Article 4(1)(a) of this Regulation, risks arising from changes in its vega referred to as 'vega risk' or 'volatility risk' as set out in Article 4(1)(b) of this Regulation, risks arising from changes in interest rates referred to as 'interest rate risk' or 'rho risk', nonlinearities which cannot be captured by gamma risk and the risk of implied correlation on basket options or warrants. Of those risks, only the gamma and vega risks are of such materiality that justify the imposition of own funds capital requirements, even for the more complex institutions and, therefore, only those types of risks should be covered in the calculation of own funds requirements. Regulation (EU) No 575/2013 requires institutions to obtain prior permission from their competent authority to use an internal model to calculate delta. However, the use of non-delta risk approaches is to be monitored and assessed under the supervisory review and evaluation process of institutions set out by the provisions of Directive 2013/36/EU of the European Parliament and of the Council[(2)]. Furthermore, the greater complexity of the scenario approach necessitates closer monitoring by competent authorities and hence, its use by institutions should be subject to specified conditions of application, both prior to its first use and on an on-going basis.

(4) Given that Article 330 of Regulation (EU) No 575/2013 concerning the treatment of fixed-to-floating interest-rate swaps applies only for interest rate risk purposes, it should not be taken into consideration for certain financial instruments such as swaptions.

(5) The provisions in this Regulation are closely linked, since they all deal with the measurement of non-delta risks of options and warrants related to different underlyings. To ensure coherence between those provisions, which should enter into force at the same time, and to facilitate a comprehensive view and compact access to them by persons subject to those obligations, it is desirable to include all the regulatory technical standards required by Regulation (EU) No 575/2013 on this matter in a single Regulation.

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

(7) 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 of the European Parliament and of the Council[(3)],

HAS ADOPTED THIS REGULATION:

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Article 1

Determination of the Own funds requirements for the non-delta risk of options and warrants

1 Institutions shall calculate their own funds requirements for market risk in relation to the non-delta risk of options or warrants as required by Article 329(3), Article 352(6) and Article 358(4) of Regulation (EU) No 575/2013, according to one of the following approaches:

a the simplified approach as set out in Articles 2 and 3 of this Regulation;

b the delta plus approach as set out in Articles 4, 5 and 6 of this Regulation;

c the scenario approach as set out in Articles 7, 8 and 9 of this Regulation.

2 When calculating own funds requirements on a consolidated basis institutions may combine the use of different approaches.On an individual basis, institutions may only combine the scenario approach and the delta plus approach subject to the conditions established in Articles 4 to 9.

3 For the purposes of the calculation referred to in paragraph 1, institutions shall take the following steps:

a break down baskets of options or warrants into their fundamental components;

b break down caps and floors or other options which relate to interest rates at various dates, into a chain of independent options referring to different time periods ('caplet' and 'floorlets');

c treat options or warrants on fixed-to-floating interest rates swaps into options or warrants on the fixed interest leg of the swap;

d treat options or warrants that relate to more than one underlying among those described in Article 5(3), as a basket of options or warrants where each option has a single distinct underlying.

[*F1**Article 2*

Only institutions that exclusively purchase options and warrants may use the simplified approach.**]**

Textual Amendments

F1 Substituted by Commission Delegated Regulation (EU) 2016/861 of 18 February 2016 correcting Commission Delegated Regulation (EU) No 528/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for non-delta risk of options in the standardised market risk approach and correcting Commission Delegated Regulation (EU) No 604/2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile (Text with EEA relevance).

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Article 3

Determination of own funds requirements according to the simplified approach

1 Institutions applying the simplified approach shall calculate the own funds requirements relative to non-delta risks of call and put options or warrants as the higher amount between zero and the difference between the following values:

a the gross amount, as described in paragraphs 2 to 5;

b the risk weighted delta equivalent amount, which shall be calculated as the market value of the underlying instrument, multiplied by the delta and then multiplied by one of the following relevant weightings:

(i) for specific and general equity risk or interest rate risk, **[**[X1]according to Part Three,**]** Title IV, Chapter 2 of Regulation (EU) No 575/2013;

(ii) for commodity risk, according to Part Three, Title IV, Chapter 4 of Regulation (EU) No 575/2013; and

(iii) for foreign exchange risk, according to Part Three, Title IV, Chapter 3 of Regulation (EU) No 575/2013.

2 For options or warrants which fall under one of the following two categories, the gross amount referred to in paragraph 1 shall be determined according to paragraphs 3 to 4:

a where the buyer has the unconditional right to buy the underlying asset at a predetermined price at the expiration date or at any time before the expiration date, and where the seller has the obligation to fulfil the buyer's demand ('simple call options or warrants');

b where the buyer has the unconditional right to sell the underlying asset in the same manner as described in point (a) ('simple put options or warrants').

3 The gross amount referred to in paragraph 1 shall be calculated as the maximum between zero and the market value of the underlying security multiplied by the sum of specific and general market risk own funds requirements for the underlying minus the amount of the profit, if any, resulting from the instant execution of the option ('in the money'), where one of the following conditions is met:

a the option or warrant incorporates a right to sell the underlying asset ('long put') and is combined with holdings in the underlying asset ('long position in the underlying instrument');

b the option or warrant incorporates a right to buy the underlying asset ('long call') and is combined with the promise to sell holdings in the underlying instrument ('short position in the underlying asset').

4 Where the option or warrant incorporates a right to buy the underlying asset ('long call') or a right to sell the underlying asset ('long put'), the gross amount referred to in paragraph 1 shall be the lesser of the following two amounts:

a the market value of the underlying security multiplied by the sum of specific and general market risk requirements for the underlying asset;

b the value of the position determined by the mark-to-market method or the mark-to-model method as provided in points (b) and (c) of Article 104(2) of Regulation (EU) No 575/2013 ('market value of the option or warrant').

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5 For all types of options or warrants which do not have the characteristics referred to in paragraph 2, the gross amount referred to in paragraph 1 shall be the market value of the option or warrant.

Editorial Information

X1 Substituted by Corrigendum to Commission Delegated Regulation (EU) No 528/2014 of 12 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for non-delta risk of options in the standardised market risk approach (Official Journal of the European Union L 148 of 20 May 2014).

Article 4

Overview of determination of own funds requirements according to the Delta-plus approach

1 Where institutions opt to apply the Delta-plus approach, for options and warrants whose gamma is a continuous function in the price of the underlying and whose vega is a continuous function in the implied volatility ('continuous options and warrants'), the own funds requirements for non-delta risks on options or warrants shall be calculated as the sum of the following requirements:

a the own funds requirements relating to the partial derivative of delta with reference to the price of the underlying which, for bond options or warrants is the partial derivative of delta with reference to the yield-to-maturity of the underlying bond, and for swaptions is the partial derivative of the delta with reference to the swap rate;

b the requirement relating to the first partial derivative of the value of an option or warrant, with reference to the implied volatility.

2 Implied volatility shall be taken to be the value of the volatility in the option or warrant pricing formula for which, given a certain pricing model and given the level of all other observable pricing parameters, the theoretical price of the option or warrant is equal to its market value, where 'market value' is understood in the manner described in Article 3(4).

3 The own funds requirements for non-delta risks related to non-continuous options or warrants shall be determined as follows:

a where the options or warrants have been bought, as the maximum amount between zero and the difference between the following values:

(i) the market value of the option or warrant, understood in the manner described in Article 3(4);

(ii) the risk weighted delta equivalent amount, understood in the manner described in Article 3(1)(b);

b where the options or warrants have been sold, as the maximum between zero and the difference between the following amounts:

(i) the relevant market value of the underlying asset, which shall be taken to be either the maximum possible payment at expiry date, if it is contractually fixed, or the market value of the underlying asset or the effective notional value if no maximum possible payment is contractually fixed;

(ii) the risk weighted delta equivalent amount, understood in the manner described in Article 3(1)(b).