Changes to legislation: *There are outstanding changes not yet made to Commission Delegated Regulation (EU) No 526/2014. 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. 526 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 526/2014 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 determining proxy spread and limited smaller portfolios for credit valuation adjustment risk (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) No 526/2014

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 determining proxy spread and limited smaller portfolios for credit valuation adjustment risk

(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 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, and in particular the third subparagraph of Article 383(7) thereof,

Whereas:

(1) The application of the advanced method to the determination of own funds requirements for Credit Valuation Adjustment (CVA) risk may involve counterparties for which no Credit Default Swap (CDS) spread is available. Where this is the case, institutions should use a spread that is appropriate having regard to the rating, industry and region of the counterparty (proxy spread) in accordance with the third subparagraph of Article 383(1) of Regulation (EU) No 575/2013.

(2) Rules on the determination of proxy spread for CVA risk should provide for the use of broad categories of rating, industry and region, and they should allow institutions the necessary flexibility to determine the most appropriate proxy spread based on their expert judgment.

(3) When specifying in more detail how the attributes of rating, industry and region of the single issuers should be considered by institutions when estimating an appropriate proxy spread for the determination of the own funds requirements, as required by Regulation (EU) No 575/2013, rules should be established for the consideration of those attributes by reference to minimum categories for each attribute, in order to ensure a harmonised application of those conditions.

(4) Furthermore, in the case of single issuers, where a link, such as between a regional government or local authority and the sovereign, exists, it should be possible to allow

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for the estimation of an appropriate proxy spread on the basis of the credit spread of a single issuer, where this leads to a more appropriate estimation.

(5) In order to lead to an appropriate computation of the CVA risk charge, a proxy spread should be determined using data that has been observed in a liquid market, and assumptions regarding data, such as interpolation and extrapolation of data relating to different tenors, should be conceptually sound.

(6) In order to ensure convergence of practices among institutions and to avoid inconsistencies, considering that implied probabilities of default (PDs), Credit Default Swaps (CDS) spreads and loss given default (LGD) constitute one equation with two unknown variables and that the market convention is to use a fixed value for LGD in order to derive implied PDs from market spreads, institutions should use a value for LGD_{MKT} that is consistent with the fixed LGD commonly used by market participants for determining implied PDs from those liquid traded credit spreads that have been used to determine the proxy credit spread for the counterparty in question.

(7) For the purposes of permission to use the advanced CVA method for a limited number of smaller portfolios, it is appropriate to consider a portfolio as a netting set as defined in Article 272(4) of Regulation (EU) No 575/2013 the number of non-internal model method ('IMM') transactions subject to the CVA risk charge and the size of non-IMM netting sets subject to the CVA risk charge, and to limit them in terms of a percentage of the total number of all transactions subject to the CVA risk charge and a percentage of the total size of all netting sets subject to the calculation of CVA risk charge, in order to take account of the different dimensions of institutions.

(8) In order to mitigate possible discontinuities in the use of the advanced CVA method for a limited number of smaller portfolios, the use of the advanced CVA method should cease only when quantitative limits are breached for two consecutive quarters.

(9) Further, in order to render it possible for competent authorities to perform their supervisory duties in an efficient manner, they should be able to know when the requirement of a limited number of smaller portfolios is no longer met; hence institutions should notify competent authorities in those cases.

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

(11) 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[(1)],

HAS ADOPTED THIS REGULATION:

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Article 1

Determining an appropriate proxy spread

1 The proxy spread for a given counterparty shall be deemed appropriate having regard to the rating, industry and region of the counterparty according to the fourth subparagraph of Article 383(1) of Regulation (EU) No 575/2013, where the following conditions are satisfied:

a the proxy spread has been determined by considering all of the attributes of rating, industry and region of the counterparty as specified in points (b), (c) and (d);

b the attribute of rating has been determined by considering the use of a predetermined hierarchy of sources of internal and external ratings. Ratings shall be mapped to credit quality steps, as referred to in Article 384(2) of Regulation (EU) No 575/2013. In cases where multiple external ratings are available their mapping to credit quality steps shall follow the approach for multiple credit assessments set out in Article 138 of that Regulation;

c the attribute of industry has been determined by considering at least the following categories:

(i) public sector;

(ii) financial sector;

(iii) others;

d the attribute of region has been determined by considering at least the following categories:

(i) Europe;

(ii) North America;

(iii) Asia;

(iv) rest of the world;

e the proxy spread reflects in a representative way available credit default swap spreads and spreads of other liquid traded credit risk instruments, corresponding to the relevant combination of applicable categories and satisfying the data quality criteria referred to in paragraph 3;

f the appropriateness of the proxy spread is determined with reference to the volatility rather than to the level of the spread.

2 In the process of considering the attributes of rating, industry and region of the counterparty in accordance with paragraph 1, the estimation of the proxy spread shall be deemed appropriate for a regional government or local authority based on the credit spread of the relevant sovereign issuer where either of the following conditions are met:

a the regional government or local authority and the sovereign have the same ratings;

b there is no rating for the regional government or local authority.

3 All inputs used in the determination of a proxy spread shall be based on reliable data observed on a liquid two-way market as defined in second subparagraph of Article 338(1) of Regulation (EU) No 575/2013. Sufficient data shall be available to generate proxy spreads for all relevant tenors and for the historical periods referred to in Article 383(5) of that Regulation.