



Association des Banques et Banquiers, Luxembourg  
The Luxembourg Bankers' Association  
Luxemburger Bankenvereinigung

2 July 2024

# Key changes introduced by the new banking package CRR3 / CRD6: Day 1



# Agenda



**01** Welcome address

**02** Presentation by the  
CSSF

**03** Q&A session

01



# Welcome address

Gilles Pierre

Head of Banking Regulation & Financial  
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## CSSF speakers

**Davy Reinard**

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Banking Policy Expert



## ABBL speakers

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Gilles Pierre

Head of Banking Regulation & Financial Markets, ABBL

# Presentation by the CSSF

02



- **Output Floor**
- **Credit Risk**
- **Credit Risk Mitigation**

# CRR3 / CRD6 package

ABBL Webinar

02/07/2024



Commission de Surveillance  
du Secteur Financier

Commission  
Surveillance  
Secteur Financier

# Introduction

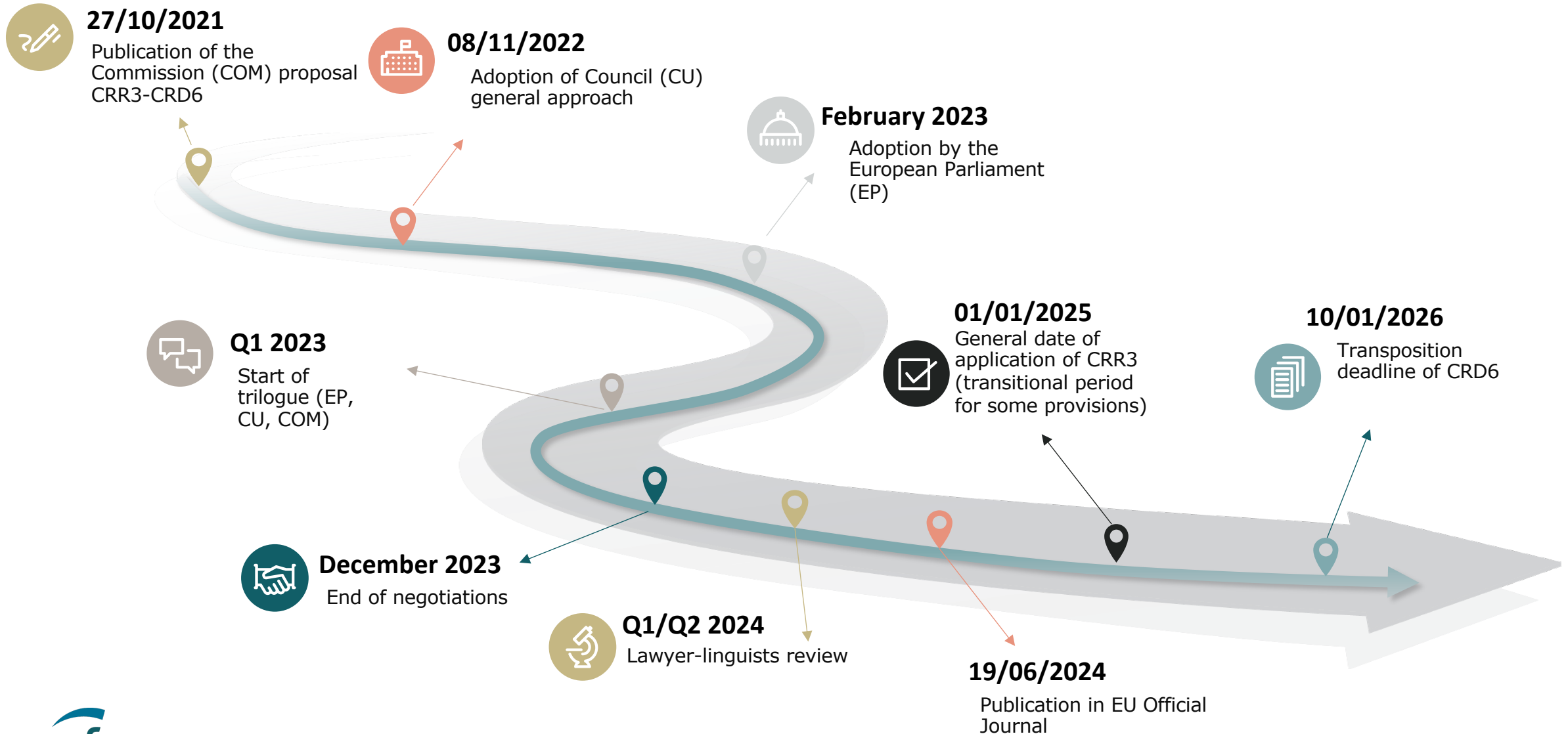
## What is CRR3 / CRD6 about?

- **Main objective of the CRR3/CRD6 review is to implement the outstanding Basel III reforms in the EU** (i.e. output floor; credit risk; market risk; operational risk).
- It also introduces **amendments in other key non-Basel areas** (i.e. fit and proper; third-country branches; environmental, social and governance (ESG) risks).

## When will it apply?

- EU co-legislators adopted a **final stable legal text in early December 2023**, which has been **published in the EU official journal on 19 June 2024**.
- CRR3 / CRD6 package will **start applying from 1 January 2025** with transition periods.

# EU implementation of the finalisation of Basel III



# Current EBA work under the new banking package

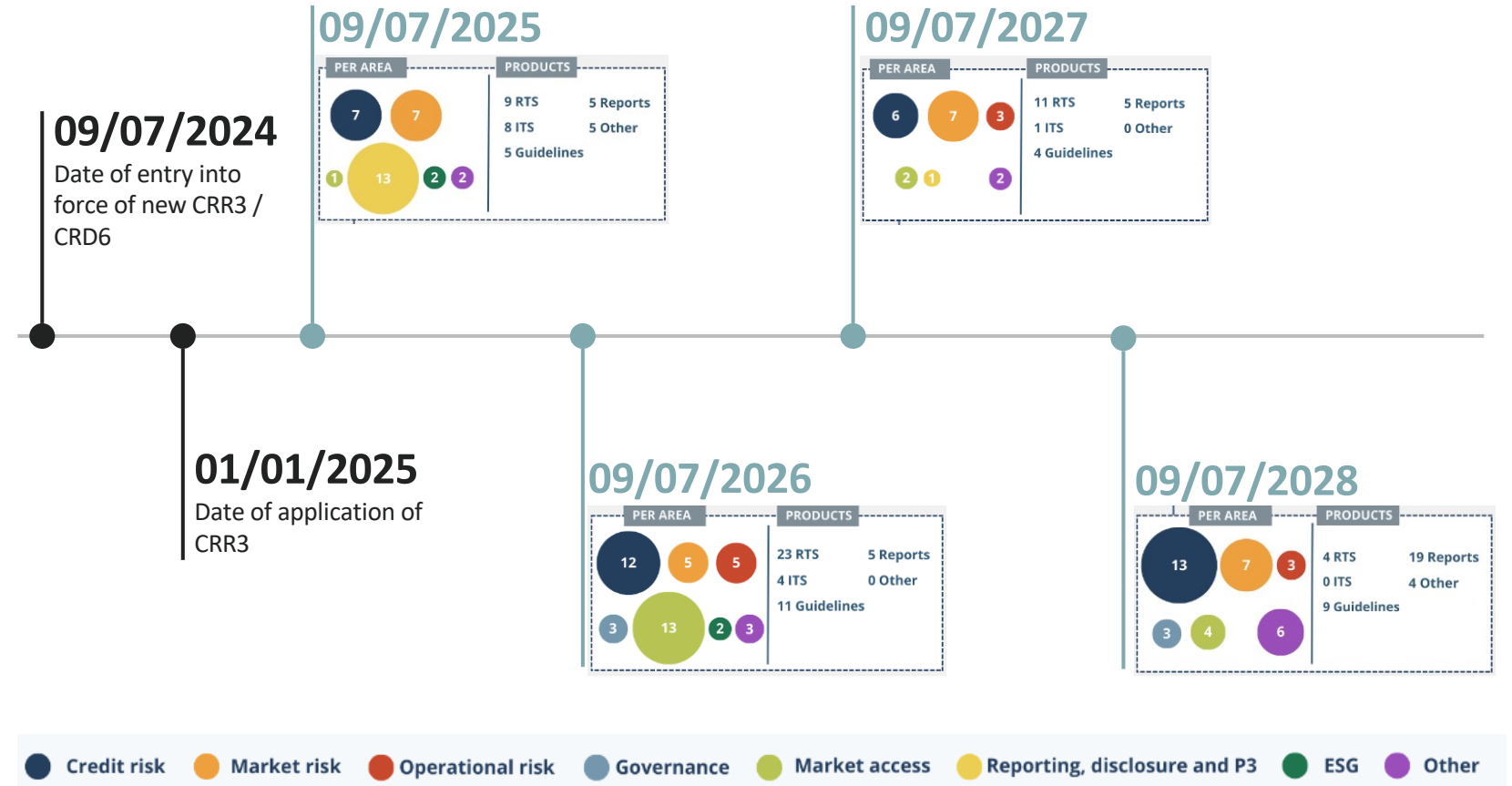
## EBA mandates

Technical clarifications to be provided by the EBA.

Total of 140 mandates, including:

- Regulatory and implementing technical standards (RTS & ITS);
- Guidelines;
- Opinions;
- Reports;
- Maintaining lists and registers.




## EBA Roadmap








Source: *The EBA publishes roadmap on the implementation of the EU Banking Package | European Banking Authority (europa.eu)*

# Agenda

## Webinar 1 – 02/07/2024

-  Output floor
-  Credit risk – standardised approach
-  Credit risk – IRB approach

## Webinar 2 – 04/07/2024

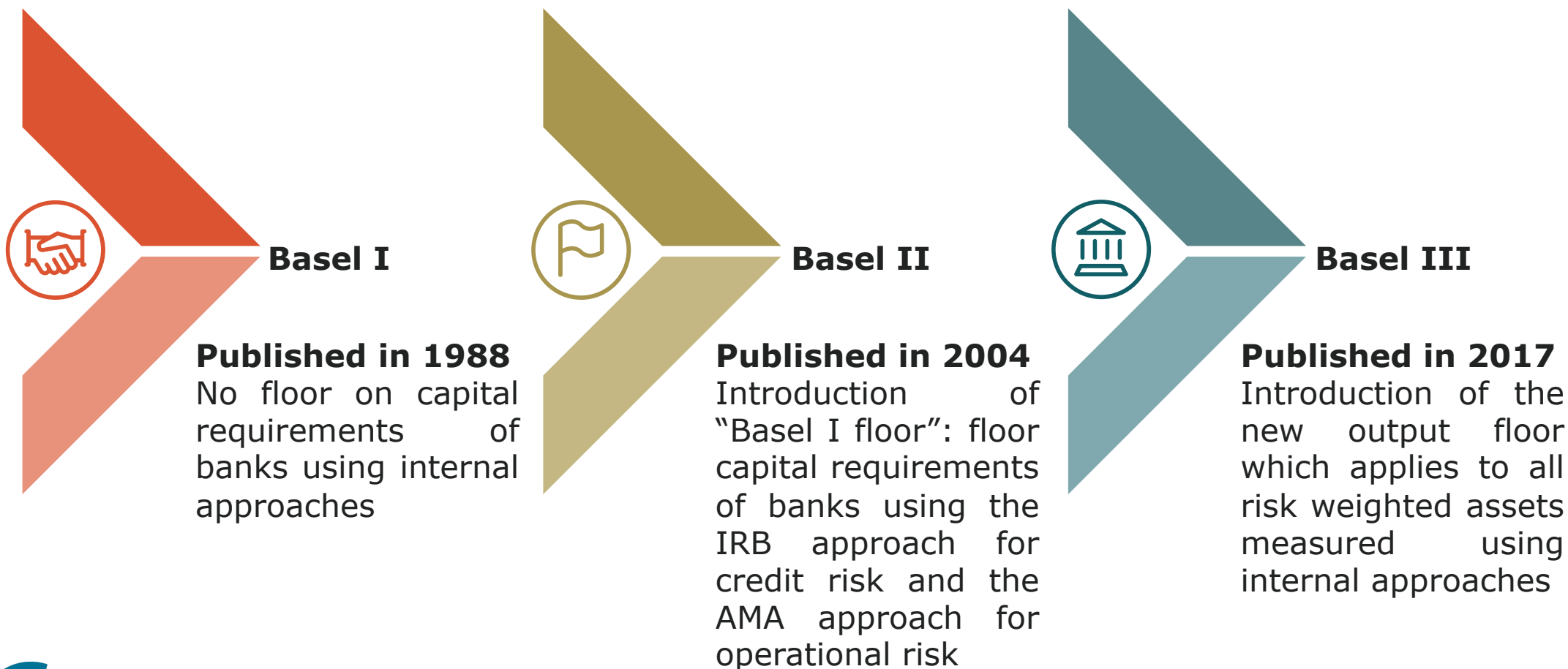
-  Operational risk
-  Market risk
-  Credit valuation adjustments risk
-  ESG risks
-  Governance - Fit and proper

# Output floor

1

# Background and purpose

The new output floor was agreed in the 2017 Basel III finalisation package and aims at reducing excessive variability of risk-weighted assets and enhancing solvency ratio comparability.



# CRR3 implementation

## Basic formula (new Article 92(3))

The **total risk exposure amount** [TREA] shall be calculated as follows:

$$\text{TREA} = \max \{ U\_TREA ; x * S\_TREA \}$$

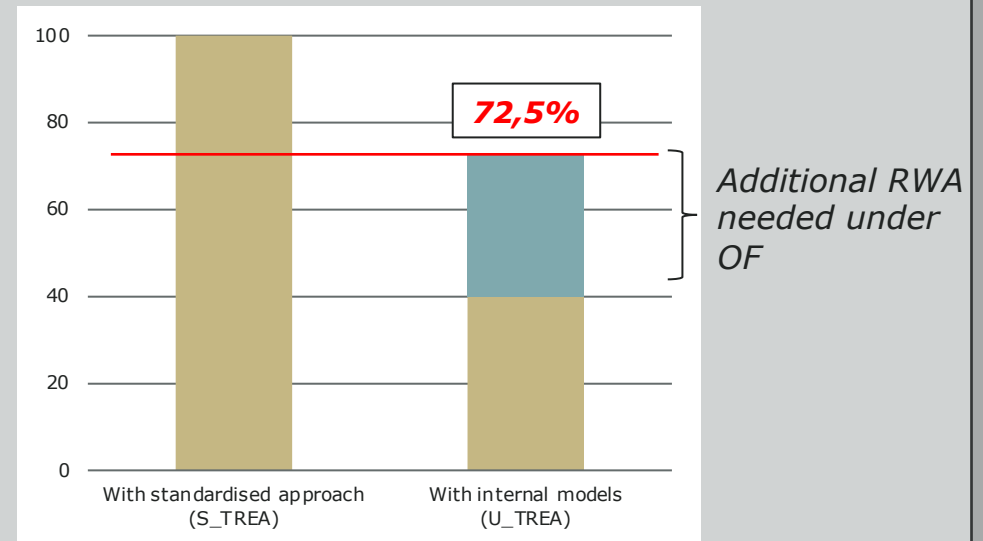
where:

- TREA = the total risk exposure amount;
- U\_TREA = the **un-floored total risk exposure amount** calculated in accordance with paragraph 4;
- S\_TREA = the **standardised total risk exposure amount** calculated in accordance with paragraph 5;
- $x = 72,5\%$  (when fully phased in).

TREA (as floored per this formula) is the denominator in banks' capital ratios.

## Illustration

The output floor ensures that total RWAs on aggregate **cannot fall below 72.5% of total RWAs computed only using standardised approaches:**



The **output floor applies at all levels of application** (e.g. consolidated, individual, where applicable sub-consolidated levels).

# Phasing-in and transitional arrangements





- The Output Floor is subject to a five-year phasing-in (as foreseen in the Basel standard, albeit two years late, in common with the entire EU implementation of the final Basel III reforms).
- The Output Floor factor “x” should apply as follows:

Year	2025	2026	2027	2028	2029	2030
OF factor « x »	50%	55%	60%	65%	70%	<b>72,5%</b>

- Banks may apply a transitional cap throughout the phase-in (until 31 December 2029), multiplying the amount of U\_TREA by 125% (Article 465(2)):

$$TREA = \min(\text{Output floor} ; 125\% * U\_TREA)$$

- The CRR also includes four transitional arrangements for calculating S\_TREA – solely for the purposes of calculating the output floor – which limit the impact of the output floor and are not foreseen in the Basel Standard:

- Article 465(3): Transitional arrangements for Unrated Corporates  *Bank discretion*
- Article 465(4): Transitional arrangements for SA-CCR (alpha factor)  *Bank discretion*
- Article 465(5): Transitional arrangement for mortgage exposures  **MS discretion**
- Article 465(13): Transitional arrangements for Securitisation  *Bank discretion*

2

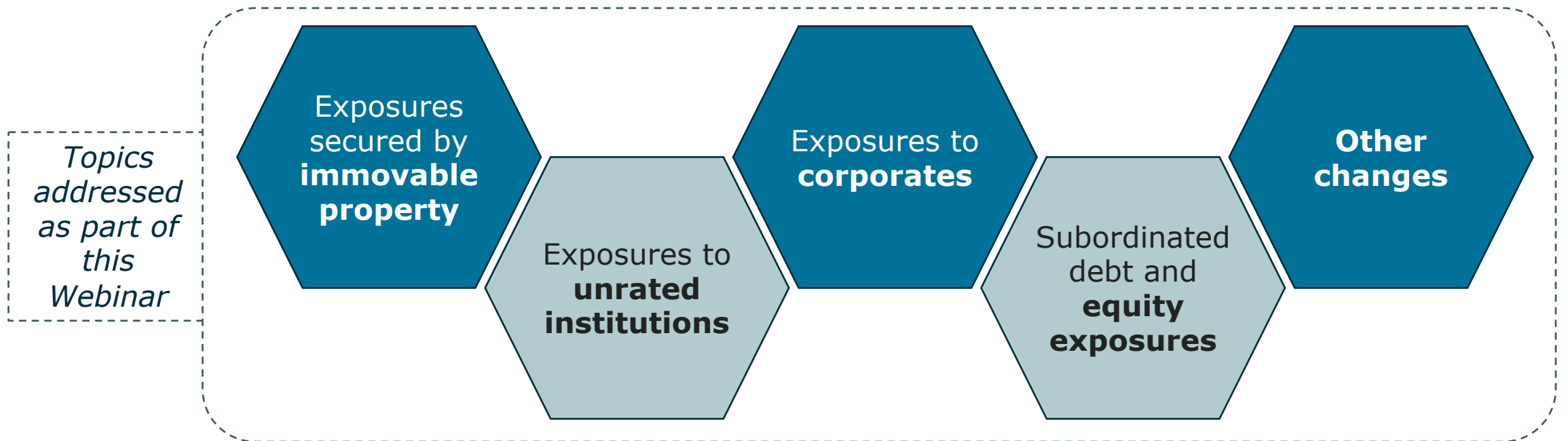
# Credit risk

Standardised approach

# Key changes made to the standardised approach

Under the CRR3, the standardised approach becomes more **granular** and more **risk sensitive**. It has been achieved through:

- Review of the approach for some types of assets;
- Introduction of **new exposure classes**;
- Changes in the **calibration** of some risk weights.



# Exposures secured by immovable property

## Review of the definition of property value (Art. 4(1) point 74a)



### CRR2

Market value, unless robust mortgage lending value in a Member State

### CRR3 (stricter)

The new definition of the property value is as follows:

- Current market price adjusted downwards to **sustainable value** over life of the loan
- In case of revaluation, ceiling at **average value over previous years** (residential real estate: 6 years / commercial real estate: 8 years)

## Recognition as secured immovable property (Art. 124)



### CRR2

Only **completed property**\* could be recognised and eligible for the preferential treatment

### CRR3 (stricter)

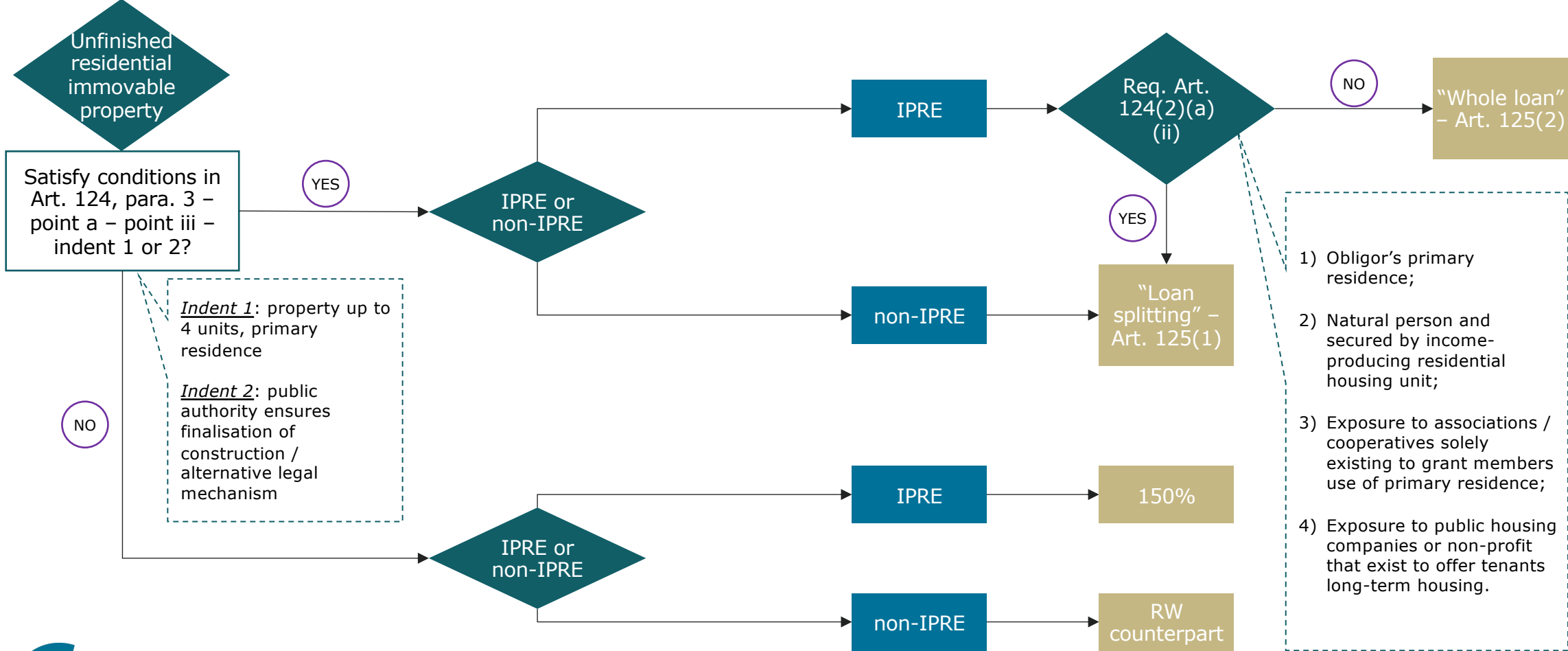
- Only completed property, unless **primary residence with max. 4 housing units**, or timely completion ensured by central government or equivalent legal mechanism
- Only **non-income producing real estate** (non-IPRE), unless primary residence, natural person (max. 4 properties), cooperative, public housing company

\* Except certain specific conditions

# Exposures secured by immovable property

## Unfinished residential property

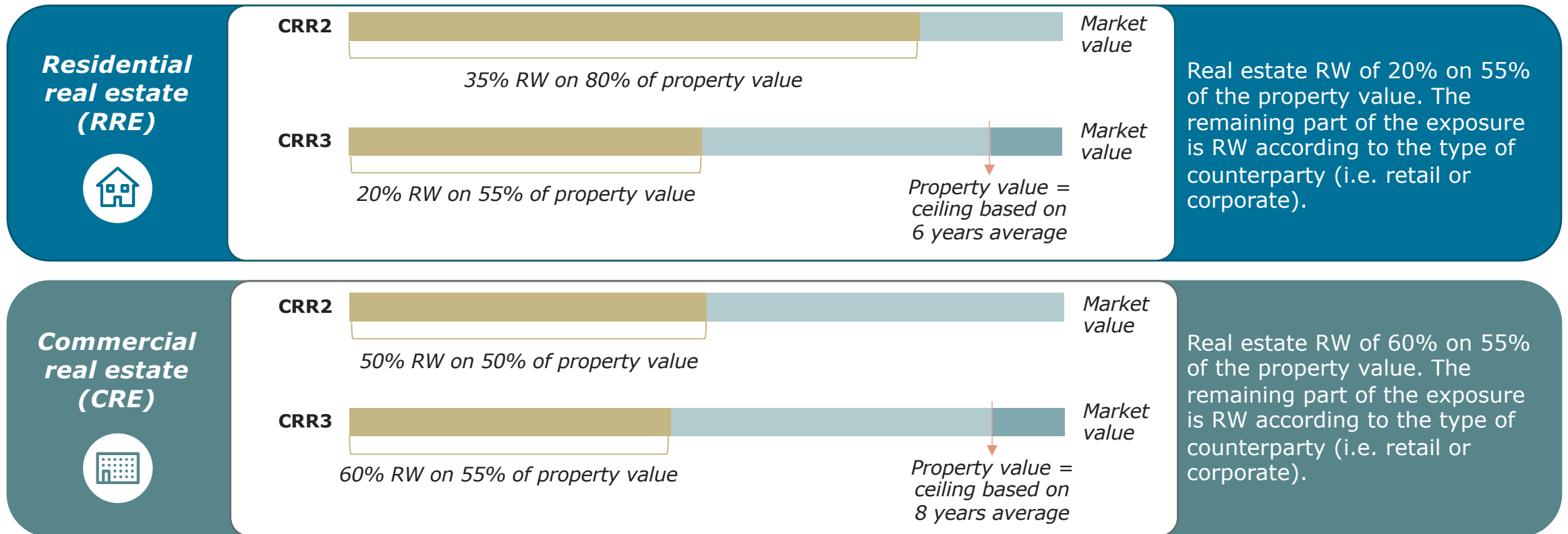
Art. 124(3)(a)(iii) Lending to natural person and immovable property either property under construction or land upon which construction is planned



# Exposures secured by immovable property

## Secured lending – loan splitting

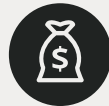
Under the so-called “loan splitting approach”, the secured part of property value benefits from preferential real estate risk weight (RW):



# Exposures secured by immovable property

## Secured lending – whole loan approach

The **whole loan approach** applies to income producing real estate exposures (IPRE), which is a new concept defined in the CRR3 – Article 4, paragraph 1, point 75b :



*"exposure secured by one or more residential properties or commercial immovable properties where the **fulfilment of the credit obligations** related to the exposure **materially depends on the cash flows generated by those immovable properties securing that exposure**, rather than on the capacity of the obligor to fulfil the credit obligations from other sources"*

CRR2

*Unsecured exposure → RW of the counterparty.*

CRR3

*RW for unfinished property: 150%*

*RW for finished property depends on the exposure-to value ratio (ETV):*

ETV	≤ 50%	≤ 60%	≤ 80%	≤ 90%	≤ 100%	> 100%
RRE	30%	35%	45%	60%	75%	105%
CRE	70%		90%	110%		

# Exposures secured by immovable property

## Land acquisition, development and construction (ADC)

New exposure class with the introduction of the new Article 126a. Land acquisition, development and construction exposures (ADC) are defined under the CRR3 Article 4, paragraph 1, point 78a:

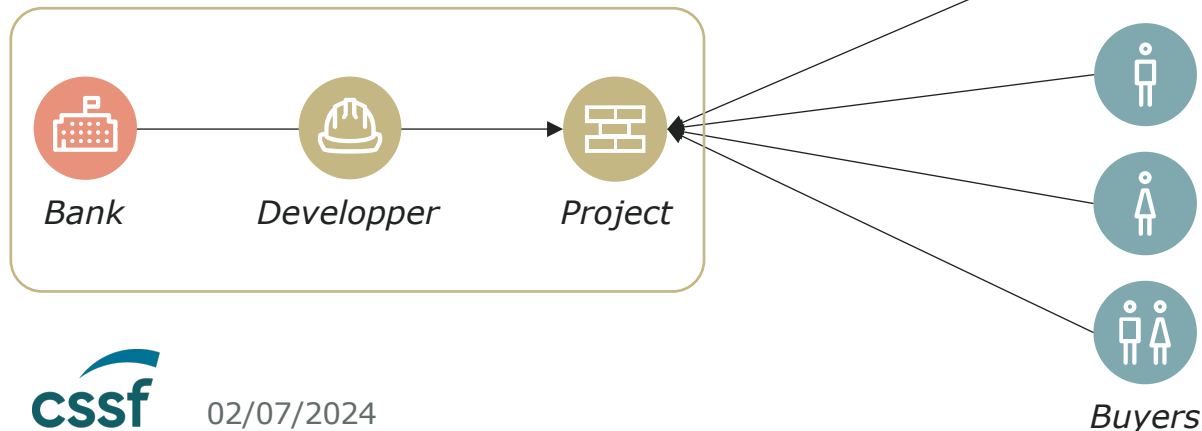


*"land acquisition, development and construction exposures", or "ADC exposures", means exposures to corporates or special purpose entities financing any land acquisition for development and construction purposes, or financing the development and construction of any residential property or commercial immovable property"*

**Step 1:** Acquisition and financing of land and potentially construction by the real estate developer

**Step 2:** Acquisition of units in the project by clients of the real estate developer

ADC covered by Article 126a



### Treatment of ADC exposures:

**RW of 150%** to be applied to ADC exposures.

**Preferential RW of 100%** if certain conditions are met. These conditions aim at ensuring the viability of the project and are about:

- The commitment of buyer in the project;
- The proportion of contracts signed in the overall project;
- The involvement of the real estate developer through equity at risk.

→ **EBA guidelines** to define the exact conditions under which the preferential treatment could apply.

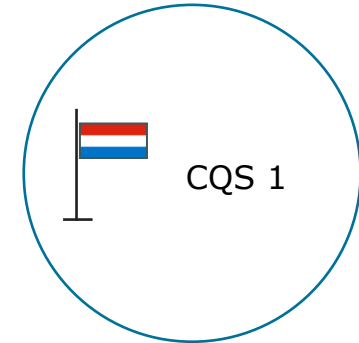
# Exposures to unrated institutions

CRR2

Under the CRR2, unrated institutions shall be assigned a **RW based on the rating of the central government** of the jurisdiction in which the institution is incorporated:

CQS central gov.	1	2	3	4	5	6
Exposure RW*	20%	50%	100%	100%	100%	150%

\*A RW of 20% applies on short-term (ST) exposures (i.e. maximum original maturity of 3 months )



No more link with central government → new **grades** based on internal assessment and compliance of the institution with published regulatory requirements.

Grade	RW	RW ST	Regulatory requirements	Adequate repayment capacity
A	40%	20%	All met	Independent of economic cycle
A+	30%	20%	+ min. 14% CET 1 & 5% leverage ratio	
B	75%	50%	Combined buffer requirements not met	Dependent on stable / favourable conditions
C	150%	150%	Other published requirements not met	Likely default under adverse economic conditions Or: external auditor has doubts on going concern ability

CRR3

# Exposures to corporates

## Corporate exposure class

- Further granularity in RW for **rated corporates**:

CQS	1	2	3	4	5,6
CRR 2	20%	50%	<b>100%</b>	100%	150%
CRR 3	20%	50%	<b>75%</b>	100%	150%

- No change in the RW to be applied on **unrated corporates**: 100%

**New specialised lending sub-class (New Article 122a)**

### New **specialised lending (SL)** sub-class:

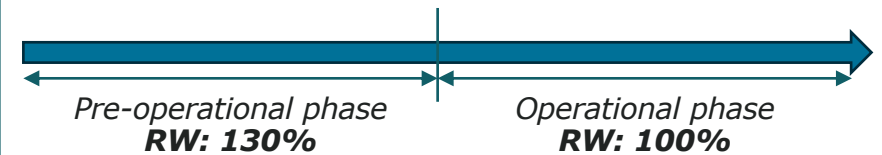
- Not related to real estate
- Obligor: SPE (or economically comparable)
- Lender with substantial control over assets and generated income
- Income generated by financed assets is primary source of repayment

### RW for **unrated SL**:

#### Object or commodity finance:

100%

#### Project finance:



- If "high quality", 80% RW for operational phase:
- Asset availability, rate-of-return, take-or-pay;
  - Sufficient reserve funds;
  - Protection against termination.

# Subordinated debt and equity exposures

## CRR2

Flat 100% RW  
unless specific cases

## Overall increase in RW under CRR3

Subordinated debt (Art. 128): **150%** RW

Equity exposures (Art. 133): **250%** (unless deducted from OF) RW with the following specific cases :

- 400% RW if short-term sale, venture capital, anticipated short-term capital gains (derogation for long-term equity investments)
- 100% RW for legislative programmes

# Other calibration changes

	Change	CRR2	CRR3
Art. 120	Lower RW for CQS 2 institutions	50%	30%
Art. 117	Flat RW for unrated multilateral developments banks (MDB)	Like unrated institutions	50%
Art. 129	RW for unrated issuers of covered bonds adapted to reflect the new treatment of institutions	N/A	15% - 35%
Art. 129	Higher RW for unrated issuers of covered bonds on which a 50% RW applies	20%	25%
Art. 123	Lower RW for retail« transactor » (revolving 1 year repaid)	75%	45%
Art. 111 & 495d	Higher CCF on unconditionally cancellable commitments, with transitional arrangements (10% CCF as of 1/1/2033)	0%	10% CCF

# Credit risk

IRB approach

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# Selected topics

1. Selective list of amended and new definitions
2. Changes to the structure of exposure classes
3. New partial use provisions
4. New restrictions on IRB modelling
5. Levels and calculation of input floors
6. Changes to the Foundation IRB approach



# Selected list of amended and new definitions

Following a.o. EBA Call for Advice, adopted from Level 2 and 3 regulation:

## Technical amendments

- PD, LGD, CCF, one-year default rate (Art.4(54)-(56),(78))
- EL, credit obligation, credit exposure, (credit) facility (Art.5(3)-(6))

## New definitions

- Margin of conservatism (MoC), appropriate adjustment, small and medium-sized enterprise (SME) (Art.5(7)-(9))
- Type of exposures, large corporates, SA-CCF, IRB-CCF (Art.142(2),(5a),(11) and (12))

# Changes to the structure of exposure classes

## **Article 147(2)**

Exposures to regional governments and local authorities (RGLA); and public sector entities (PSE) now defined as separate exposure classes (point (aa))

Corporate exposures now separated into (i) general corporates; (ii) specialised lending exposures; and (iii) corporate purchased receivables (point (c))

Retail exposures now separated into (i) qualifying revolving retail exposures (QRRE); (ii) retail exposures secured by residential property; (iii) retail purchased receivables; and (iv) other retail exposures (point (c))

Exposures in the form of units or shares in a CIU (point (ea))

## **Article 147(3a)**

RGLA-PSE exposures treated as exposures to central governments and central banks (CGCB) under the Standardised approach in accordance with Art.115 or Art.116 to be assigned to CGCB exposures in the IRB approach

# New partial use provisions

## Article 148

Principle: IRB is to be implemented for all exposures within an exposure class

Roll out: Maybe carried out sequentially across different types of exposures within a certain exposure class within the same business unit and across different business units in the same group

Implementation period to be determined by the competent authorities

Flexibility not to be used selectively for the purpose of achieving reduced own funds requirements

## Article 150

Permanent partial use (PPU): equity exposures; exposures without prior permission of the competent authorities or for some types of exposures within an exposure class, including exposures of foreign branches and different product groups, where immaterial in terms of size and perceived risk profile (to be further clarified in future EBA Guidelines)

Current specific PPU (CGCB and assimilated RGLA-PSE, intra-group, etc.) maintained

## Articles 149 and 494d

Reversion to the Standardised approach: if demonstrated that not with a view to engaging in regulatory arbitrage, including by unduly reducing own funds requirements; necessary on the basis of the nature and complexity of the institution's total exposures of that type; and would not have a material impact on the solvency of the institution or its ability to manage risk effectively

Three-year transitional provision for reversion to less sophisticated approaches

# New restrictions on IRB modelling

Type	Details	CRR3 References
Mandatory partial use	Mandatory permanent partial use of the Standardised approach for equity exposures, with some transitional/phasing-in arrangements until 31 December 2024	Art.150(1)(a), 495 and 495a
Mandatory Foundation IRB approach	No own estimates of LGD and mandatory use of the Standardised CCF (SA-CCF) for exposures to large corporates (other than specialised lending exposures), institutions and financial sector entities	Art.151(8), first subparagraph
Mandatory use of SA-CCF	Mandatory partial use of the SA-CCF for off-balance sheet items other than undrawn revolving commitments	Art. 151(8), second subparagraph and (9)
PD input floor	New PD floors, except for exposures to or guaranteed by CGCB, for the purpose of calculating risk-weighted exposure amounts (RWEA) and expected loss (EL) amounts	Art. 159a, 160(1) and (2), 163(1)
LGD input floor	LGD floors, except for exposures to or guaranteed by CGCB, for the purpose of calculating RWEA and EL amounts (phasing-in for specialised lending exposures until 31 December 2029)	Art.159a, 161(4) to (6),164(4) to (7), 495b
CCF input floor	In case of own estimates of CCF (IRB-CCF) for undrawn revolving commitments, <u>exposure value</u> floored at drawn plus 50%·SA-CCF·undrawn, except for exposures to or guaranteed by CGCB, for the purpose of calculating RWEA and EL amounts	Art.159a, 166(8c)
Output floor	New output floor which applies to all RWEA using internal approaches	Art.92(3)

# Levels and calculation of input floors

## PD input floors

- Corporates and institutions: 0.05% (Art.160(1))
- RGLA and PSE: 0.03% (Art.160(2))
- Retail (Article 163(1)):
  - QRRE: 0.1%
  - Non-QRRE: 0.05%

## LGD input floors

### Corporate exposures (Art.161(4))

Exposure without eligible FCP (LGD <sub>U-floor</sub> )	Exposure fully secured by eligible FCP (LGD <sub>S-floor</sub> )	
25 %	financial collateral	0 %
	receivables	10 %
	residential property or commercial immovable property	10 %
	other physical* collateral	15 %

RGLA-PSE:  $LGD_{U-floor} = 5\%$  (Art.161(5))

### Retail exposures (Art.164(4))

Exposure without FCP (LGD <sub>U-floor</sub> )		Exposure secured by FCP (LGD <sub>S-floor</sub> )	
Retail exposure secured by residential property	N/A	Retail exposure secured by residential property	5 %
QRRE	50 %	QRRE	N/A
Other retail exposure	30 %	Other retail exposure secured by financial collateral	0 %
		Other retail exposure secured by receivables	10 %
		Other retail exposure secured by residential property or commercial immovable property	10 %
		Other retail exposure secured* by other physical collateral	15 %

$$LGD_{floor} = LGD_{U-floor} \cdot \frac{E_U}{E \cdot (1+H_E)} + LGD_{S-floor} \cdot \frac{E_S}{E \cdot (1+H_E)} \quad (\text{Art.161(6) and 164(4a)})$$

## CCF input floors

Exposure value floor = drawn amount + 50% · SA – CCF · undrawn amount (Art.166(8c))

Exemption from input floors for exposures to or guaranteed by CGCB (Art.159a)

# Changes to the Foundation IRB approach

## Article 161(1)

Senior “unsecured” exposures for CGCB, RGLSA-PSE and financial sector entities: 45%

Senior “unsecured” exposures for corporates: 40% (CRR2: 45%)

Senior purchased corporate receivables without own estimates: 40% (CRR2: 45%)

Dilution risk of purchased corporate receivables: 100% (CRR2: 75%)

For the recognition of eligible funded credit protection (FCP):

$$LGD^* = LGD_U \cdot \frac{E_U}{E \cdot (1 + H_E)} + LGD_S \cdot \frac{E_S}{E \cdot (1 + H_E)}$$

## Article 230

Type of FCP	LGDs	Volatility adjustment (H <sub>c</sub> )
Financial collateral	0%	As set out in Articles 224 to 227
Receivables	20%	40%
Residential property and commercial immovable property	20%	40%
Other physical collateral*	25%	40%
Ineligible FCP	Not applicable	100%

\*Phasing-in until 31 December 2029 for leasing exposures as a credit risk mitigation technique (Art.495c)

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02/07/2024



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03



Q&A Session

## ***Q1 Opening question – Main impacts of the CRR3 / CRD6***

Which are from the CSSF perspective the 3 most significant impacts of the CRR3 / CRD6 on Luxembourg banks?



# Output Floor

## ***Q2 Scope of application, art. 92 CRR3***

Under which conditions would a Luxembourg bank be authorized to calculate the Output Floor on a consolidated basis?

***Q3 Transitional Period for Residential Real Estate exposures - Lower risk weights, art. 465.5 CRR3***

What is the CSSF position regarding the lower Risk Weights that may be allowed for Residential Real Estate exposures during the transitional period (e.g. 10% RW up to 55% of the property value until December 2032)?

## ***Q4 Considering Credit Risk Mitigation for calculating the Output Floor***

Article 108 CRR3 specifies how Credit Risk Mitigation can be considered for the calculation of the Output Floor set out in article 92.4, i.e. for the Un-floored Total Risk Exposure Amount (U-TREA).

What about requirements for the Standardised Total Risk Exposure (S-TREA) of article 92.5?



# Credit Risk: Standardised Approach

## ***Q5 Critical assessments of external ratings***

What is the CSSF view on the amendments introduced in article 113.1, where external credit ratings must be disregarded if the bank's own assessment of the debtor's credit risk concludes on a higher risk?

## ***Q6 Grading of unrated credit institutions***

Is the grading (A,B or C) of unrated credit institutions the responsibility of the lending institution (through in-house due diligence), or can we expect to have additional guidance? What would be the expected frequency of review of the criteria laid down in article 121 CRR3, notably article 121.3(b)?

## **Q7** *Definition of Income Producing Real Estate Exposures (IPRE)*

Is there further description of "materiality" within the definition of IPRE in article 4.1 (75b) CRR3?

*"the fulfilment of the credit obligations related to the exposure **materially** depends on the cash flows generated by those immovable properties securing that exposure, rather than on the capacity of the obligor to fulfil the credit obligations from other sources"*

## ***Q8 Major renovations for the purchased property***

Article 124.3 (a)(i) and (a)(iii) CRR3 specifies the conditions of eligibility of residential properties, which may be "fully completed" or "under construction".

How should major renovations made to the purchased property be considered in this regard?



# Credit Risk Mitigation

***Q9 Requirements for immovable property collateral:  
applicability to approaches for credit risk***

We understand that article 208 CRR3 is applicable to banks using the Standardised and the Foundation IRB Approaches for credit risk. Can the CSSF confirm this?

**Q10 Requirement for immovable property collateral: Insurance,  
art. 208.5 CRR3**

What are the minimal criteria of *adequate insurance of property against the risk of damage* that the procedures should consist of to be assessed as effective?

***Q11 Valuation of the immovable property: applicability to all approaches for credit risk, art. 229.1 CRR3***

Is this article applicable under all approaches for credit risk, i.e. Standardised Approach, Foundation IRB and Advanced IRB?

***Q12 Valuation of the immovable property: comparable properties,  
art. 229.1 (e) CRR3***

What are CSSF's view/expectations on the notion of comparable properties?

**Q13 Valuation of the immovable property: value at origination,  
art. 229.1 (e) CRR3**

There is no specific definition of the value at origination in the CRR3. Valuation at the point of origination for an immovable property is referred to in point 7.1 of the EBA Guidelines on Loan Origination and Monitoring of May 2020.

Is it acceptable to retain the value of the *compromis de vente* or of the deed of sale as the value at origination?

***Q14 Valuation of the immovable property: Improvements of the energy performance or to the resilience of the property, art. 229.1 (e) CRR3***

The value of the property can exceed the average value or the value at origination in case of improvements of the energy performance or of improvements to the resilience of the property.

How can we define an improvement of the energy performance or an improvement to the resilience of the property?

***Q15 Valuation of the immovable property: Upward revaluation,  
art. 229.1 (e) CRR3***

In case of upward revaluation, what are the CSSF expectations in case there are insufficient data points to calculate the average value? Can we keep the value at origination for the ETV/LTV calculation?

Thank you for your  
attention!



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