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

4 July 2024

Key changes introduced by the new banking package CRR3 / CRD6: Day 2

Agenda

01 Welcome address

02 Presentation by the CSSF

03 Q&A session

01

Welcome address

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02

Presentation by the CSSF

- Operational Risk
- Market Risk
- CVA Risk
- ESG Risks
- Governance - Fit and Proper

Agenda

Webinar 1 – 02/07/2024	*Webinar 2 – 04/07/2024*
Output floor	Operational risk
Credit risk – standardised approach	Market risk
Credit risk – IRB approach	Credit valuation adjustments risk
	ESG risks
	Governance - Fit and proper

1

Operational Risk

Drawbacks of current methods

Basic Indicator Approach (BIA)	Simplistic, capital requirement calculation based on fixed % of gross income → do not reflect accurately the OR (risk sensitivity & unsuitable components)
Standardised Approach (SA)	Could produce counter-intuitive results from the net losses (e.g. negative contributions to the capital charge)
Advanced Measurement Approaches (AMA)	Highly complex and lack of comparability arising from a wide range of Internal Modelling practices leading to variability in RWA calculation

Complete review of the operational risk framework

Current CRR	CRR3
1 Basic Indicator Approach (BIA)	**Articles 311a to 323**
2 Standardised Approach (SA)	NEW Standardised approach (NEW SA)
3 Advanced Measurement Approaches (AMA)	

Replacement of all the current approaches for measuring the OR capital requirements with a **new Standardised Approach (SA)**

Basel versus EU implementation

Basel formula

ORC = Business Indicator Component (BIC) × Internal Loss Multiplier (ILM)

At the Basel level, there are two main elements to the calculation of the operational risk capital charge : **BIC & ILM**

CRR3 (EU) formula

ORC = Business Indicator Component (BIC) × ~~Internal Loss Multiplier (ILM)~~

The European legislator has decided to apply the discretion (§12) provided for in Basel (i.e. **ILM=1**)

Article 312 to 315 CRR

Detailed formula

ORC = Business Indicator Component (BIC)

Business Indicator (BI) × BI marginal coefficients

$$ILDC = min(IC, 0{,}0225 \cdot AC) + DC$$

Interest, leases and dividend component (ILDC)

+

$$SC = max\,(OI, OE) + max\,(FI, FE)$$

Service component (SC)

+

$$FC = TC + BC$$

Financial component (FC)

Average 3 year

BI Level

	12%
EUR 1bn	
	15%
EUR 30bn	
	18%

Article 314 – 315 CRR

Article 313 CRR

Business Indicator

- Includes **items sensitive to OR**, that are omitted or netted from the definition of Gross Income (e.g. P&L from the banking book, fee and commission expenses, other operating expenses);
- **Avoids counter-intuitive results** (e.g. negative contributions to the capital charge from net trading losses, banks showing different gross, and similar net, volumes of fees and commissions);
- **Reduces the weight of components** which are associated with activities traditionally **less exposed to OR** (e.g. interest income generated by pure lending activity);
- **Increases the weight of the FC and SC**, which are associated with activities more closely associated with operational risk
- **Ability to capture** a bank’s business volume which reflects operational risk

Case Study

$$BI = ILDC + SC + FC$$

A $$ILDC = min(Abs(interest\ income - interest\ expense), 2{,}25\% * Asset\ Component) + dividend\ income$$

Examples of items :
- Interest income → from financial assets [HFT, FVTPL, FVTOCI]
- Interest expenses → from financial assets [HFT, FVTPL, FVTOCI]
- Asset component → cash balances at central bank, debt securities, loans and advances

B $$SC = max(other\ operating\ income, other\ operating\ expense\ ) + \max(fee\ income, fee\ expense)$$

Examples of items :
- Other operating income → income from changes in FV in tangible assets measured using the FV model, other income
- Other operating expense → expense from changes in FV in tangible assets measured using the FV model, losses, expenses, provisions and other financial impacts due to operational risk events, staff expenses,
- Fee and commission income → from securities, from clearing & settlement, from asset management
- Fee and commission expenses → from securities, from clearing & settlement, from asset management

C $$FC = Abs(Net\ P\&L\ trading\ book) + Abs(Net\ P\&L\ banking\ book)$$

Examples of items :
- Trading book → Gains or (-) losses on financial assets and liabilities HFT, exchange differences (trading)
- Banking book → Gains or (-) losses on financial assets and liabilities FVTPL, exchange differences (other than trading)

Case Study

A

$$ILDC = min(Abs(interest\ income - interest\ expense), 2{,}25\% * Asset\ Component) + dividend\ income$$

EUR billion	Y-3	Y-2	Y-1				Average 3 year
IC	10,00	16,00	15,00				13,67
AC	460,00	490,00	350,00	433,33	*	2,25% =	9,75
Min (IC, AC*2,25%)							9,75
DC	0,50	1,00	1,00				0,83
ILDC = (Min (IC, AC*2,25%)+DC							10,58

$$BI = ILDC + SC + FC$$

22,08

B

$$SC = max(other\ operating\ income, other\ operating\ expense\ ) + \max(fee\ income, fee\ expense)$$

EUR billion	Y-3	Y-2	Y-1	Average 3 year	Max
OI	2,00	3,00	3,00	2,67	3,67
OE	4,00	5,00	2,00	3,67	
FI	6,00	5,00	4,00	5,00	5,00
FE	3,00	3,00	3,00	3,00	
SC = max (OI,OE) + max (FI,FE)					8,67

C

$$FC = Abs(Net\ P\&L\ trading\ book) + Abs(Net\ P\&L\ banking\ book)$$

EUR billion	Y-3	Y-2	Y-1	Average 3 year
TC	1,00	2,00	1,00	1,33
BC	1,00	1,50	2,00	1,50
FC = TC + BC				2,83

Case Study

$$BI = ILDC + SC + FC$$

22,08

Split	BI	Marginal Coeficient	EUR Billion
BIC bucket 1	1,00	12%	0,12
BIC bucket 2	21,08	15%	3,16
BIC bucket 3	0	18%	0,00
		BIC	**3,28**

$$RWAs = BIC * 1250\%$$

40,03

Calculation of the Annual Operational Risk Loss

Articles 316 – 322 CRR3	
	- Annual Operational Risk Loss to be calculated and reported by **all Banks with BI ≥ EUR 750 mln** - All losses above KEUR 20 and KEUR 100 thresholds - Losses become relevant after their accounting impact (i.e. **accounting date**) - **Net loss after all recoveries** including insurances recoveries - The **scope of the OR loss is clearly defined** (Yes: direct charges, costs, provisions, pending losses, timing losses. No: costs due to maintenance, improvement) - **Applied to all the group with a 10Y observation period** - **Minimum qualitative criteria** (processes, mechanisms, IT systems, etc) for identification, collection, treatment and reporting of op risk losses - **Review from supervisors every 5Y (3Y if BI > EUR 1 Bn)**

Operational risk management framework

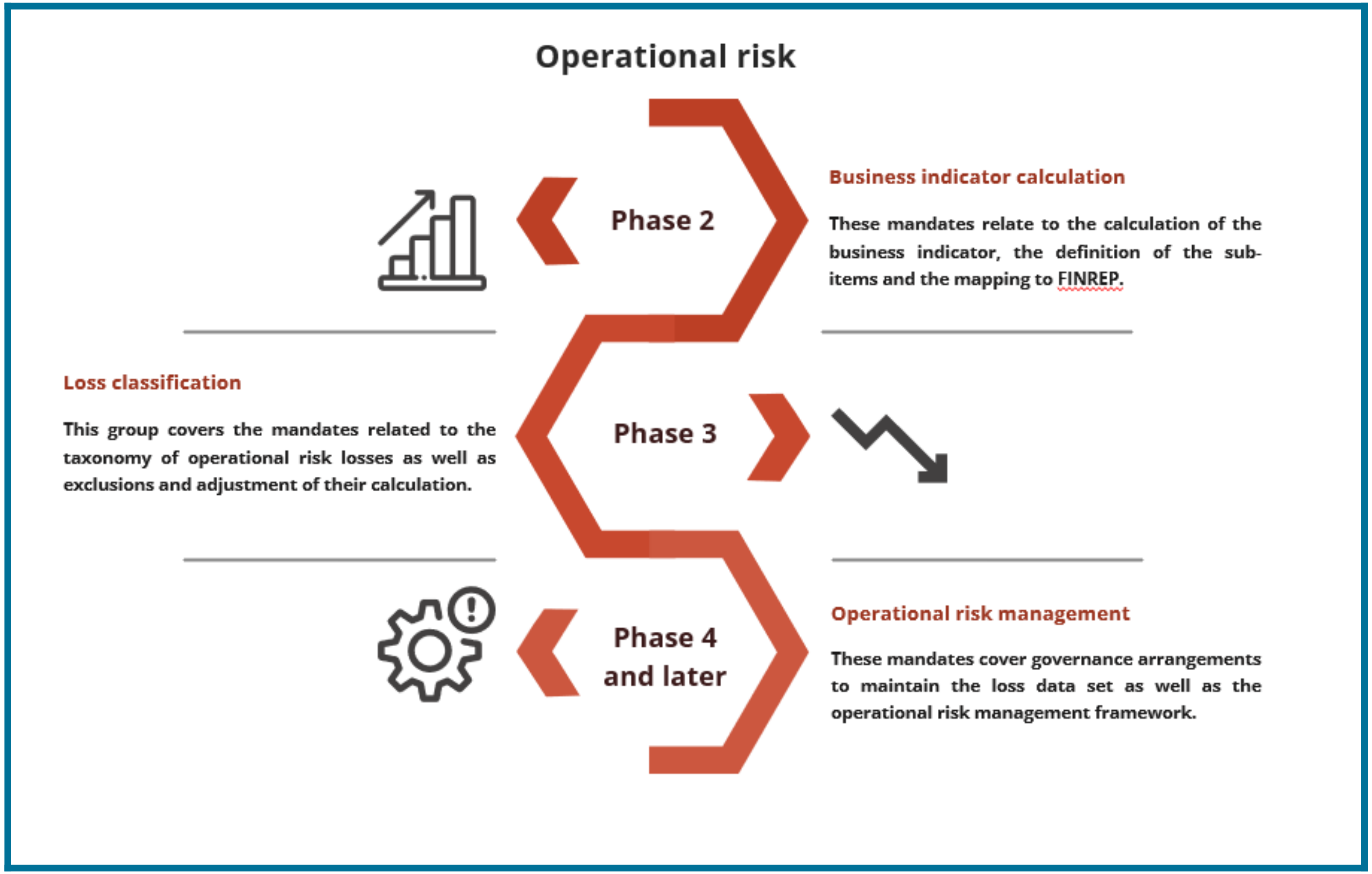
Article 323 CRR3	■ **Requested to all banks**, regardless of their size ■ **Assessment and Management System**: to monitor and control the operational risk profile, assign clear responsibilities, and track relevant operational risk data, including material loss data ■ **Independent RMF**: separate from its business and operational units ■ **Reporting System**: to provide operational risk reports to senior management and relevant functions ■ **Monitoring and corrective Actions**: Regular review of operational risk assessment and management processes and systems by internal and external auditors ■ **Internal Validation Processes** ■ **Transparent Data Flows** ■ **Proportionality criteria** to be developed by the EBA in specific RTS

EBA Mandates on Operational Risk - Phases

Phase 2: this phase includes the mandates with deadlines up to **2** years after the entry into force of the CRR

Phase 3: this phase includes the mandates that are expected to be finalised within 3 years after the entry into force of the CRR

Phase 4: this phase includes the remaining mandates with deadlines of four years after the entry into force of the CRR or later.



EBA Mandates on Operational Risk - Detail

Product	Legal Text	Article	Deliverable	Phase	Legal deadline	Status
RTS	CRR	314(9)	RTS on the elements to calculate the business indicator components	2	18 months after entry into force	Consultation phase is over
ITS	CRR	314(10)	ITS on mapping BIC components to FINREP	2	18 months after entry into force	Consultation phase is over
RTS	CRR	315(3)	RTS on adjustments of the BIC	2	18 months after entry into force	Consultation phase is over
RTS	CRR	316(3)	RTS on calculation of aggregated losses above EUR 750 million and unduly burdensome exemption	2	18 months after entry into force	Consultation phase is ongoing
RTS	CRR	317(9)	RTS establishing a risk taxonomy of operational risk loss events	2	18 months after entry into force	Consultation phase is ongoing
RTS	CRR	320(3)	RTS on the exclusion of losses	3	30 months after entry into force	Not yet started
RTS	CRR	321(2)	RTS on the adjustments to the loss dataset	3	30 months after entry into force	Consultation phase is ongoing
RTS	CRR	323(2)	RTS on the risk management framework	3	30 months after entry into force	Not yet started
Report	CRR	314(3)	Report on operational risk ILDC	4	72 months after entry into force	Not yet started
Guidelines	CRR	317(10)	Guidelines on governance arrangements to maintain the loss dataset	4	No deadline	Not yet started

2

Market risk

Market Risk: CRR2/3 Background

CRR2 introduced the following changes

Reporting requirements for the new FRTB approaches (Article 430b+325a):

(alternative) standardised approach and (alternative) internal model approach

While Own Fund Requirements are calculated with the (current) standardised approach or the (current) internal model approach (Art.325)

Art.94 Derogation for small trading book

Boundary/scope aspects from the Basel III FRTB rules were only partly included in CRR2 (Art.102-104)

- reclassification between trading book and non-trading (banking) book, and
- the internal risk transfer between books

CRR3 addresses the following issues

- Missing boundary/scope aspects and definitions (point 144 + Art.104)
- Turns the reporting requirements into Own Funds Requirements
- Introduces some adjustments to existing FRTB rules
- Proposes transitional arrangements and empowers COM to adjust or delay FRTB in a delegated act.

Basel III FRTB Framework comes into force as from 01/01/2026 (*)

* *Keynote speech by Commissioner McGuinness*

Introduced by Basel III and transposed into CRR3

1. Boundary between Trading Book (TB) and Banking Book (BB)

CRR3 Art. 104 — ***New clear cut between TB and BB instruments***

1 TB instruments

Art.104(2) *"Inclusion in the TB"*

- ACTP
- Net short credit/equity positions
- Securities underwriting

- Accounting TB
- Market making
- CIU with trading intent
- Listed equities
- Trading related SFTs
- Embedded options

2 BB instruments

Art.104(3) *"Inclusion in the TB"*

- Securitization warehousing
- Real-estate holdings related investments
- Unlisted equities
- Retail and SME credit-related instruments
- Other CIU
- Own liabilities

- Hedge funds

3 Derogations of the rule

Art.104(4) *"Inclusion in the TB"*

Possible for green bullet points based on NCA approval:

- Further explained ECB expectations to banks in Guide on options and discretions (update is in progress)
- Further explained process for the approval to JST in a new Fiche (in progress)

Introduced by CRR2, slightly modified with CRR3

1. Boundary between Trading Book (TB) and Banking Book (BB)

CRR3 Art. 104a — *Reclassification of a position in exceptional circumstances*

1 Reclassification is possible

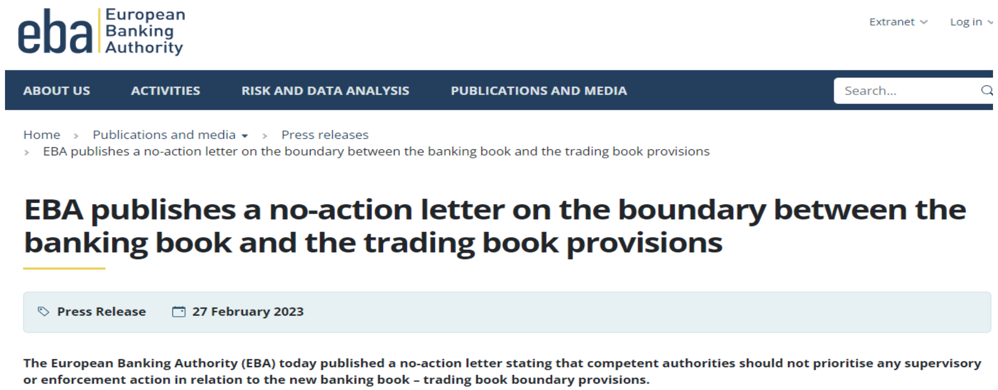
Reclassification of positions between TB/BB after initial recognition is only possible after NCA approval in exceptional circumstances

- EBA will issue Guidelines what is exceptional circumstances (in progress)
- The bank might reclassify a position for accounting reason without prior permission, but the capital penalty remains

Introduced by CRR2 from 28/06/2023, but postponed by [EBA opinion on non-action letter]

2 The capital penalty is applied

The capital penalty is applied, if reclassification of positions between TB/BB results in reduction in OFR than this reduction will not be recognized until this position matures (unless otherwise approved by NCA)



CRR3 Art.104(c)

Treatment of foreign exchange risk hedges of capital ratios

1. reviously CRR2 Art 352(2) now moved to this general part
2. Currently defined with EBA Guidelines on Structural FX
3. Will be substituted with new RTS on structural FX

EU frame-work

- Take over most of requirements in EBA GL on SFX

[Guidelines on the treatment of structural FX positions]

- New proposal: limit maximum number of eligible currencies, enhance governance requirements for less liquid currencies for which there might be disturbances
- Introduce SFX reporting in the COREP framework (in line with RTS requirements)
- RTS needs to be developed into 2 years

CRR3 Art. 104b — Requirements for Trading Desk

1 TB/BB book positions

Paragraph 1 now references to OFR instead of reporting. Moreover, it does not only refer to "trading book positions" but also to "non-trading book positions" referred to in paragraphs 5 and 6

This was missing before but already included in the draft FRTB Supervisory expectations which was shared with concerned JSTs and institutions.

2 Treatment of FX and Commodities

Paragraphs 5 and 6 are added to specify the treatment of FX and Commodity exposure in the Banking Book. If these positions are included in specific "nominal" trading desk, the "qualitative" requirements in paragraphs 1-3 do not apply

4. Internal Hedges

CRR3 Article 106

Paragraphs 3 and 4: Small modifications (reference updates); explicit requirement that hedge and hedged positions shall be assigned to the same trading desk

Paragraph 4a(new) clarifies that the external hedge might be composed of multiple transactions with multiple eligible third-party protection providers

Paragraph 5 point(a) and point(b) now reference to OFR instead of reporting. Moreover, the new paragraph 5a was added dealing with additional trades that can be included in the IRT (Internal Risk Transfer). The new paragraph 5b details the requirements for additional trades that can be included in the IRT desks and clarifies that those trading desk do not need to meet the „qualitative" requirements in paragraph 104(1-3)

CRR2 paragraphs 6 and 7 are combined in CRR3 paragraph 6 about a calculation on a stand-alone basis of OFR for the market risk of all the positions assigned to the separate portfolio

New paragraph 7: Clarification on the treatment of internal CVA hedges indicating the conditions where an institution hedges a CVA risk exposure using a derivative instrument entered into with its trading book. The position in that derivative instrument shall be recognised as an internal hedge for the CVA risk exposure for the purpose of calculating the own funds requirements for CVA risks

5. Approaches for calculating the OFR for market risk

CRR3 Article 325

Specifies that FRTB ASA and AIMA should be used for OFR => CRR2: Reporting only

Simplified standardised approach calculation (current SA + multipliers depending on the instrument type) CRR3 Article 325a: An institution may calculate the own funds requirements for market risk, provided that the size of the institution's on- and off-balance-sheet business subject to market risk is equal to or less than each of the following thresholds, on the basis of an assessment carried out on a monthly basis using data as of the last day of the month

All non-trading book positions that are subject to foreign exchange risk or commodity risk shall be included, except those positions that are excluded from the calculation of own funds requirements for foreign exchange risk in accordance with Article 104c or that are deducted from the institution's own funds

Requirements on combinations of approaches. New: at consolidated level SSA (simplified SA) can be used together with ASA and IMA, but not at individual level

IMA OFR at least 10% of MR OFR <=> was already in Art. 430b(5) in CRR2

No securitizations or correlation trading positions in the IMA ⇔ similarly to before

6. Scope, structure and qualitative requirements of the ASA – new requirements

CRR2 Art.325c

Par (2a) – OFR for own debt instruments: bank needs to calculate SBM and curvature charge (DRC is not calculated)

For SBM the bank shall exclude from that calculation the risks from the institution's own credit spread

Par (3) – Requirements to have a risk control unit that is independent from business trading units and that reports directly to senior management

Par (4)&(5) – Need for independent review of ASA to satisfaction of NCA

By internal audit or external qualified party

It shall cover both the activities of the business trading units and of the independent risk control unit

At least once a year, or on a less frequent basis of up to every two years if approved by NCA

Par (5a) – NCA to verify that the ASA OFR calculation, including the ASA implementation by a bank is performed with integrity

EBA shall develop RTS to specify the assessment methodology for this verification within 4 years

For fulfilment of requirements of paragraph (4) and (5) and (5a) there will be public expectations to banks as part of OND Guide, and detail internal guidance on its process for JSTs in Fiche document

CRR3 Art. 325bo	***Recognition of hedges in an internal DRC*** Paragraph 3 is replaced to clarify the treatment of maturity mismatches: *" In their internal default risk models, institutions shall capture material basis risks in hedging strategies that arise from differences in the type of product, seniority in the capital structure, internal or external ratings, vintage and other differences.* *Institutions shall ensure that maturity mismatches between a hedging instrument and the hedged instrument that could occur during the one-year time horizon, where those mismatches are not captured in their internal default risk model, do not lead to a material underestimation of risk."*
CRR3 Art. 325bp	***Particular requirements for an internal DRC*** Paragraph 5 includes the new PD floors: • 0.01% for exposures to which a 0% risk-weight is applied. • 0.01% for covered bonds to which a 10% risk-weight is applied. The default probabilities shall be floored at 0.03% otherwise.

10. CRR3-changes: Other aspects

Article 430: Amended to specify **reporting requirements for SA and IMA**. On the other hand 430b [Specific reporting requirements for market risk] was deleted => New Corep tables for TB MR

Article 461a: The COM **shall monitor the differences** between the implementation of the international standards on MR OFR in the EU and third countries: impact in terms of own funds requirements and the date of application. Where significant differences are observed, COM is empowered to delay (up to two years) or scale down MR (for up to three years) => Might delay the IMA decision process

Article 495h: Transitional arrangements SIs are allowed to include red and amber TD in IMA until 1 January 2026 institutions may use, until 1 January 2026, the alternative internal model approach to calculate their own funds requirements for market risk for trading desks that do not meet the requirements referred to in Article 325bg
=>Could be important for the IMA decision drafting

Article 500c: Adapted a COVID measure to FRTB
Competent authorities may, in exceptional circumstances and in individual cases, permit institutions to exclude the overshootings evidenced by the institution’s back-testing on hypothetical or actual changes from the calculation of the addend set out in Article 325bf, provided that those overshootings do not result from deficiencies in the internal model and provided that they occurred between 1 January 2020 and 31 December 2021 => No impact in Luxembourg

3

CVA risk

CRR3 Art. 381

CVA risk was added to the existing CVA definition

1 CRR (current definition)	2 CRR3 (additional part)
…"credit valuation adjustment" or "CVA" means an **adjustment to the mid-market valuation of the portfolio of transactions with a counterparty** That adjustment reflects the current market value of the credit risk of the counterparty to the institution, but does not reflect the current market value of the credit risk of the institution to the counterparty	…'CVA risk' means the **risk of losses arising from changes in the value of CVA**, calculated for the portfolio of transactions with a counterparty as set out in the first paragraph, **due to movements in a counterparty's credit spreads risk factors and in other risk factors embedded in the portfolio of transactions**

CRR3 Art. 382 — Scope of transactions

1 CRR1 (current definition)

In general, OFRs for all OTC derivative instruments
Exemptions:
(1) Credit derivatives recognised to reduce credit risk RWAs
(3) Transactions with qualifying CCPs (and for certain client trades)
(4) Corporates below EMIR clearing TH, intra-group trades, pension funds and sovereign counterparties

(2) An institution shall include in the calculation of own funds required securities financing transactions that are fair-valued under the accounting framework applicable to the institution where the institution's CVA risk exposures arising from those transactions are *material => RTS (in progress)*

2 CRR3 (additional part)

EBA RTS mandate in (6) to define "material"

(4a) institution may choose to calculate CVA OFR for the transactions excluded pursuant to (4), where the institution uses eligible hedges determined in accordance with Article 386 to mitigate the CVA risk of those transactions. Institutions shall establish policies to specify the application and calculation of the own funds requirements for CVA risk for such transactions.

(4b) requires OFR reporting including hypothetical OFRs if no transaction was be exempted in (4)

New approaches for CVA risk

CRR3 introduces

BA-CVA
Basic approach uses CCR exposure value and effective maturity of the netting set. It doesn't require a permission (CRR3 Art. 384)

Simplified approach
only for small banks (CRR3 Art. 273a)
uses the CCR RWA/12.5 (CRR3 Art. 385)
Simplified must not be used in combination with SA- or BA-CVA

SA-CVA
Standardised approach allows to model exposures, and thus requires a permission from Competent Authority (CRR3 Art. 383)

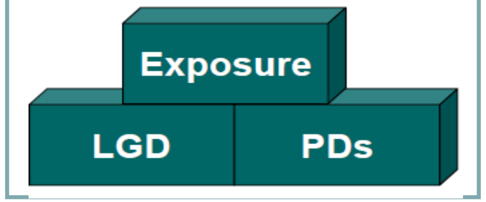
Options

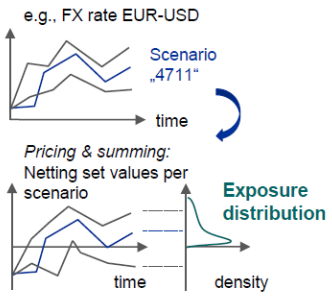
SA-and BA-CVA can be combined mixing between:

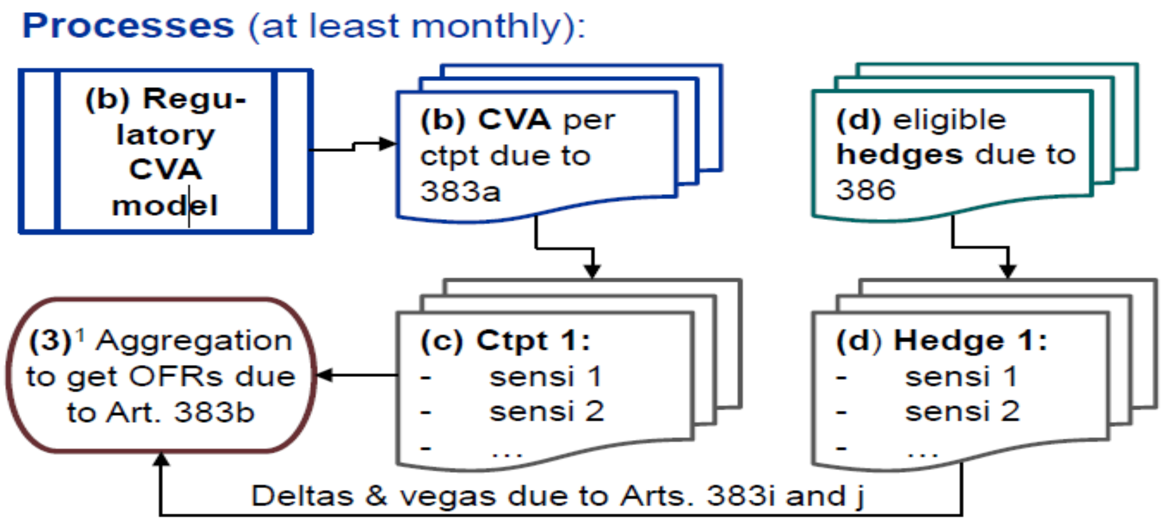
(a) counterparties,
(b) nettings sets for one counterparty,
(c) within on netting set splitting it in two hypothetical ones (SA-CVA with permission and BA-CVA) and documenting this split on a permanent basis

Art. 383: SA-CVA

CRR3 introduces







Options

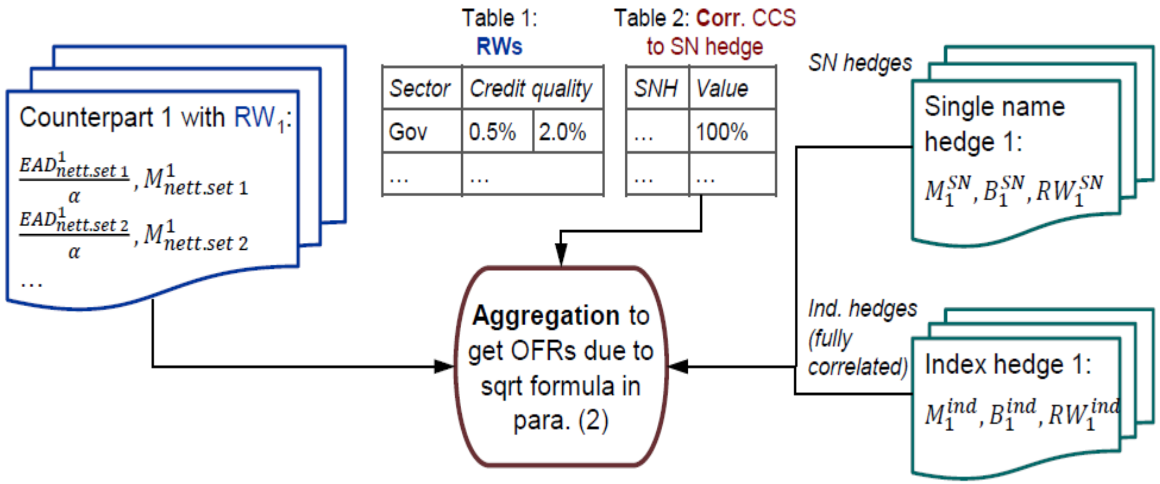
At each future time point, the simulated discounted future exposure of the portfolio of transactions with a counterparty is calculated with an **exposure model by repricing all the transactions in that portfolio**, **based on the simulated joint changes of the market risk factors that are material to those transactions** using an appropriate number of scenarios, and discounting the prices to the date of calculation using risk-free interest rates

Art. 384: BA-CVA

CRR3 introduces

Exposure values per netting set divided by α = 1.4

Effective maturities per netting set due to CRR Art. 162



Options

Without hedges: Only based on "CVA sensis" per counterparty

With hedges: Based on "CVA sensitivities" per counterparty (EAD from CCR), and "sensis" per single name hedge & per index hedge also using supervisory discount factors = f(maturity)

Art. 385: Simplified Approach CVA

CRR3 introduces

Can only be calculated by an institution that has CA permission due CRR Art.273a(4) to apply the “Original exposure method” for CCR under conditions of para (2) of the same article:

The size of its on-and off-balance-sheet derivative business is equal to or less than both of the following thresholds (on a monthly basis):

(a) 5 % of the institution’s Total Assets
(b) EUR 100 million

The OFRs for CVA risk: RWA_CCR x 8% due CRR Art. 92(4)(a) and (g)

Other conditions

(a) only transactions subject to CVA risk due to CRR Art. 382 are taken into consideration
(b) credit derivatives recognised as internal hedge against CCR must not be included

An institution that no longer meets one or more of the conditions set out in Article 273a(2) or 273a(4) must comply with the requirements of Article 273b (partly updated in CRR3)

Eligible Hedges

CRR3 Art. 386

*(1)**Positions in hedging instruments shall be recognised as eligible hedges** for the calculation of CVA OFR meet all of the following requirements:*

*(a) they are used for the **purpose of mitigating CVA** risk and are managed as such.*
*(b) they can be entered into with third parties or with the institution's **TB an internal hedge.***
(c) only positions in hedging instruments listed below can be recognised as eligible hedges.

(2) Additional conditions for SA-CVA approach:
- instruments that hedge variability of the counterparty credit spread.
- instruments that hedge variability of the exposure component of CVA risk.

Such hedging instruments form a single position in an eligible hedge and are not split into more than <u>one position in more than one eligible hedge</u>.

(3) Additional conditions for BA-CVA approach:
- single-name credit default swaps and single-name contingent-credit default swaps, referencing the counterparty directly, or a legally related entity (parent undertaking or its subsidiary), or entity that belongs to the same sector and region as the counterparty.
- index credit default swaps.

4

ESG risks

ESG risks integration in current prudential framework

1

No specific treatment.

EBA on going work assessing potential adjustments to prudential framework to account for environmental and social risks (CRR 501c)

2

ESG risks are covered by the general risk management requirements for banks with out explicit mentions.

ECB Guide on climate-related and environmental risks

Circular CSSF 21/773 On the Management of Climate-related and Environmental Risks

EBA Report on ESG risks management and supervision

3

Large listed institutions to disclose on ESG risk following ITS 2022/2453.

ESG risks integration in CRR3 CRD6

Mapping articles to topics

ESG risks are **explicitly** addressed in several articles of CRR3 and CRD6.

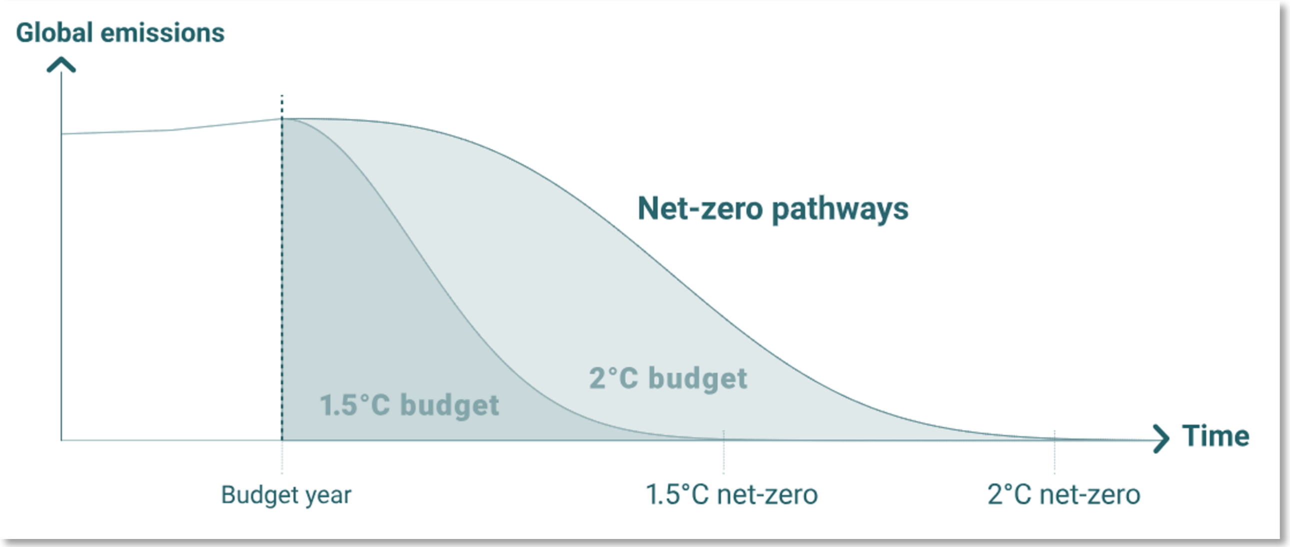
The S and G in ESG, as they are intertwined with E, although the **focus remains on E**.

	Banks	Supervisors	EBA	Disclosure and reporting	Internal governance	Risk management	Credit risk	Market risk	Operational risk incl. reputational	Business model and strategy	Prudential transition plans	Stress testing and ICAAP	Macroprudential tools
CRD6 – Art. 3 – Definitions	●	●	●	●	●	●	●	●	●	●	●	●	●
CRR3 – Art. 4(1) – Definitions	●	●	●	●	●	●	●	●	●	●	●	●	●
CRR3 – Art. 449a – Disclosure of ESG risks	●		●	●	●	●	●	●	●	●			
CRR3 – Art. 430 – Reporting on prudential requirements and financial information	●		●	●			●	●	●				
CRR3 – Art. 433b – Disclosures by small and non-complex institutions	●			●			●		●				
CRD6 – Art. 91– Management body and suitability assessment	●				●								
CRD6 – Art. 74 – Internal governance and resolution plans	●				●	●							
CRD6 – Art. 76 – Treatment of risk	●				●	●					●		
CRD6 – Art. 87a– Environmental, social and governance risks	●	●	●		●	●				●	●	●	
CRR3 – Art. 208 – Requirements for immovable property collateral	●						●						
CRR3 – Art. 210 – Requirements for other physical collateral	●						●						
CRR3 – Art. 207 – Requirements for financial collateral	●							●					
CRR3 – Art. 325as – Risk weights for commodity risk	●							●					
CRR3 – Art. 383v – Risk weights buckets for commodity risk	●							●					
CRD6 – Art. 98 – Technical criteria for the SREP		●	●		●	●	●	●	●	●	●		
CRD6 – Art. 104 – Supervisory powers		●			●	●	●	●	●	●	●		
CRR3 – Art. 501c – Prudential treatment of exposures to env. or social factors			●				●	●	●				
[CRR3 – Art. 505 – Review of agricultural financing]			●				●	●	●				
CRD6 – Art. 73 – Internal capital	●											●	
CRR3 – Art. 177 – Stress tests used in assessment of capital adequacy	●		●				●					●	
CRD6 – Art. 100 – Supervisory stress testing			●									●	
CRD6 – Art. 133 – Requirement to maintain a systemic risk buffer		●											●

Key points of the ESG risks integration
Transition plans

Banks shall develop **"Prudential" transition plans** to manage the risk arising from the adjustment towards relevant MS or EU objectives.

CRD 76 (2)



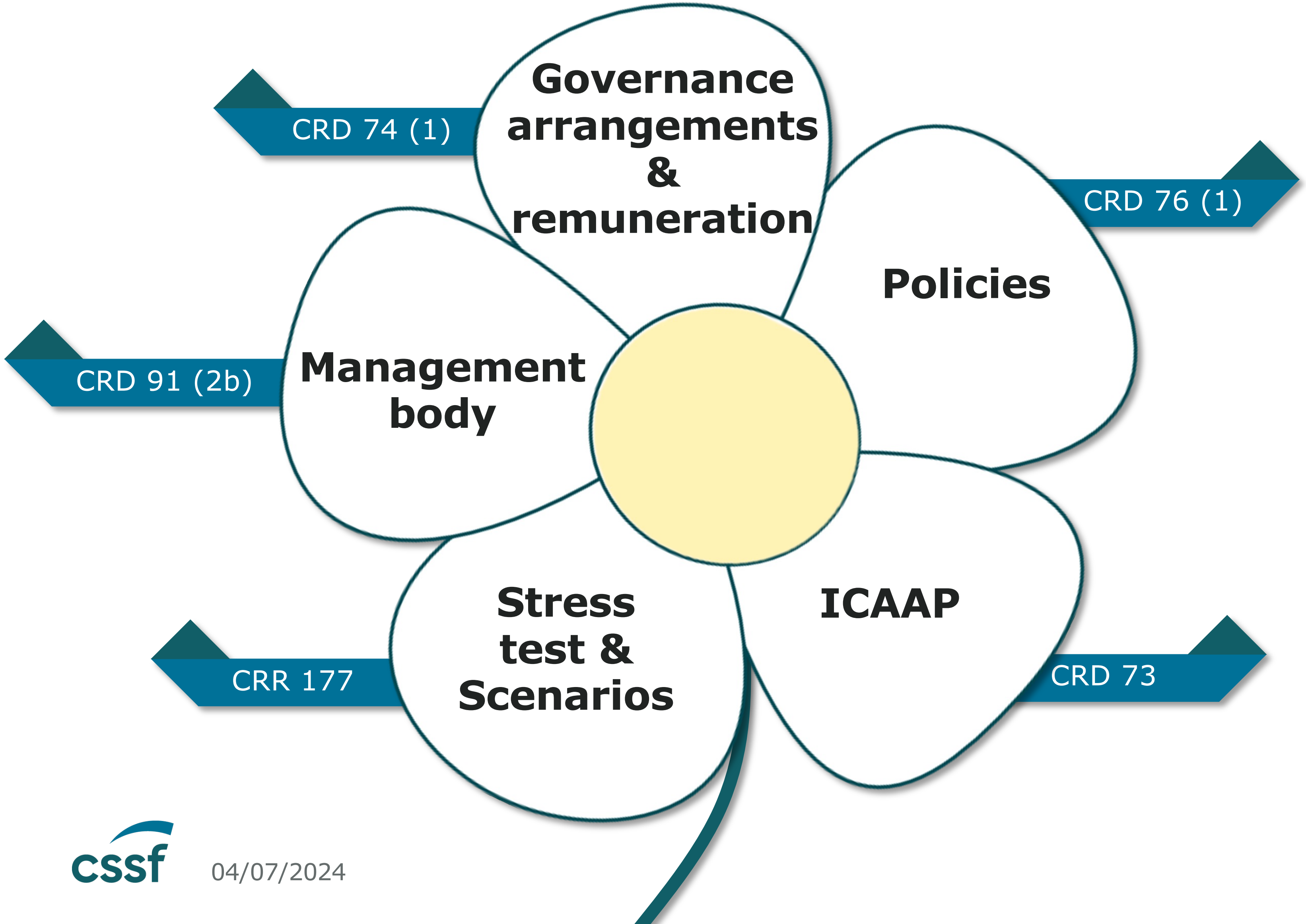
"**Prudential**" transition plans shall be consistent with Corporate Sustainability Reporting Directive (**CSRD**) transition plans.

EBA will issue **guidelines** on the content of transitions plans.

Supervisors to assess robustness of the plans within **SREP**.

CRD 98 (1,9)

Key points of the ESG risks integration
Explicit reference to consideration of ESG risks



Supervisory Powers

ESG-related governance processes as part of the **SREP**. Supervisors can request **banks to reduce their ESG risks** through adjustments to business strategies, governance arrangements and risk management processes.

CRD Art. 98	***CRD Art. 104***

Key points of the ESG risks integration

Only targeted considerations in pillar 1

Credit risk

Banks to update **collateral** valuations in case of high likelihood to become impacted by ESG factors, considering also adequacy of insurance against damage and obsolescence.

CRR 207, 208, 210

Market risk

Preferential treatment for market risk exposures to carbon trading for the EU **Emissions Trading** System (ETS).

CRR 325as, 383v

EBA to continue assessing the way to adjust pillar 1 to address ESG risk.
← No capital requirements for Green or Brown assets.

Key points of the ESG risks integration
Expansion of disclosures and reporting

1 3

Public disclosures (P3)

Specification in CRR level 1 text requirements already detailed in ITS 2022/2453 on:
- **exposures to fossil fuel sector entities**;
- institutions integration of ESG risks in business strategy and processes, and governance and risk management.

Expansion of entities within scope: Small and non-complex intuitions also to make ESG disclosures.

CRR 449a

CRR 433b

Prudential reporting

Regular reporting on exposures to ESG risks, including – but not limited to –exposures to the **fossil fuel sector** and exposures to **physical** and **transition risks.**

EBA to develop ITS.

CRR 430

5

Governance – Fit and proper

Primary novelties stemming from CRD VI can be categorised into several topics

1. Primary responsibility of banks regarding suitability of MB members
2. Enhanced governance arrangements & collective suitability
3. Ex-ante applications (for countries with ex-post regime)
4. Suitability assessment for/and KFH

Please be advised that CRD VI has not yet been transposed into Luxembourg law.

(18 months from the date of entry into force at the latest)

1. Primary responsibility of banks regarding suitability of MB members

Article 91(1)	**Primary responsibility of all entities** (Banks + approved (M)FHC) for ensuring that members of the management body are **at all times** of:

1. Sufficiently good repute
2. Act with honesty, integrity and independence of mind
3. Possess sufficient knowledge, skills & experience

Article 91(1a)	Obligation for entities to assess the suitability of members of the management body **before they take up their positions.**
Article 91(1b)	If members of the management body are not suitable, **obligation for entities to take remediation measures**:

1. Either NOT to appoint the prospective member
2. Remove member from the management body
3. Ensure that member becomes suitable for position

Article 91(1h)	Primary responsibility of the entities to **reassess the suitability** of the members of the management body as soon as the entities become aware of **new facts** which could affect the suitability. Competent authorities (ECB & CSSF) shall be informed thereof without undue delay.

2. Enhanced governance arrangement & collective suitability

Article 88(3)

Obligation for banks to have **individual statements setting out and mapping the roles and duties** (e.g., reporting lines, lines of responsibility) of:

1. **All Members of MB in management function**
2. **Senior Management**
3. **KFH**

New definitions Article 3(1)8a,9,9a CRD

Article 88(1e)

No discretion for MS to allow a **Chair of the supervisory board** to exercise simultaneously the functions of a **CEO** within the same institution.

ESG

Article 91(7)

On collective suitability, obligations for entities to provide trainings to members of management bodies on **ESG** and **ICT** related risks.

3. Ex-ante applications (for countries with ex-post regime)

Article 91 (1d – 1e)

Obligation for « **large entities** » to submit the suitability application:

- **as soon as there is** clear **intention to appoint certain members***, and
- in any event, at the latest **30 working days before** the prospective members take up the position.

Limited scope:

a. « Large entities » [Art. 91(1d)]

*b. *Management body in its executive function & Chair of management body in its supervisory function*

- **Possibility** for the competent authority **to block the appointment in case of insufficient information**.
- Possibility for the competent authority to engage in an ***enhanced dialogue*** with the banks **in case of concerns** → Mandate to EBA to issue GLs on the notion.

Article 91(1j)

ECB / CSSF shall duly consider setting a maximum period for concluding the suitability assessment of MB members, which may be extended where appropriate.

Article 91(12)

Review clause: Report to be prepared by 2029 by the EBA in close cooperation with the ECB on the efficiency of the ex-ante application provision.

For Luxembourg the ex-ante regime applies!

Article 91a

Obligation for competent authorities to perform an assessment of KFH

As of today, KFH are not subject to formal authorization unless e.g., appointment of CRO (considered to be part of the Authorised Management)

Heads of Internal Control functions

Chief Compliance Officer

Chief Risk Officer

Chief Internal Auditor

+ CFO (if not in the board)

Limited scope:
« Large entities » as defined under Article 91a(5)

Two Fit and Proper criteria are applicable for KFH:

- ✓ Knowledge, skills and experience
- ✓ Reputation

- ✗ Conflicts of interest & independence of mind
- ✗ Time commitment
- ✗ Collective suitability

Article 76(5)

Banks shall have **internal control functions:**
- independent from the operational functions;
- with sufficient authority, stature, resources; and
- with access to the management body.

CRD V: Limited to Risk Management function

Internal control functions shall:
- ensure that **all material risks are properly identified, measured and reported (lit. a)**;
- provide a **comprehensive view of the whole range of risks that the institution is exposed to (lit. b)**

Risk Management function (lit. c)	***Compliance function (lit. e)***	***Internal Audit function (lit. d)***
▪ actively involved in elaborating the risk strategy and in all its material risk management decisions; ▪ control over the effective implementation of the risk strategy.	▪ assesses and mitigates compliance risk; ▪ ensure that risk strategy considers compliance risk; ▪ Ensures that compliance risk is adequately considered in all material risk management decisions.	*performs an independent review of the effective implementation of the institution's risk strategy.*
Second Line of Defence		***Third Line of Defence***

Article 76(6)

Internal control functions shall have **direct access to and report directly to the management body in its supervisory function** (MBSF).

Internal control functions shall:
- **exercise the functions independently** from the members of the management body in its management function (MBMF) and from senior management, and
- be **able to raise concerns and warn the MBSF** where appropriate or where specific risk developments affect or can affect the bank, without prejudice to responsibilities of the MB.

The internal audit function shall **NOT be combined with any other business line or control function** of the bank.

Heads of Internal control functions

Heads of internal control functions shall be **independent senior managers with distinct responsibility for the risk management, compliance and internal audit functions**.

Proportionality: Senior person that performs other tasks within the institution may fulfil the responsibilities for the compliance or risk management functions, provided that:
(i) there is no conflict of interest;
(ii) the person responsible possesses the knowledge and expertise needed; and
(iii) the person responsible has the time needed to perform both control functions correctly.

The heads of the internal control functions shall **NOT be removed without prior MBSF approval**.

04/07/2024

03

Q&A Session

Operational Risk

Q1 Calculation of the annual operational risk loss, art. 316 CRR3

Is the Business Indicator threshold of 750 million € for calculating the annual operational risk loss applicable at local entity level or at the Group consolidated level ? The question is raised in the context of Luxembourg subsidiaries of a Group having a BIC < 750 million €.

Q2 Scope of application of the loss data set

Are the requirements to maintain a loss data set defined in art 317.1 point applicable for the institutions with a Business Indicator < 750 million €?

Q3 Calculation of gross loss: cost of repair

Does the cost of repair mentioned in art. 318.2 (b) include the internal cost of staff spending time to recover / restore the position before the risk event occurred ?

Q4 *Mapping of the Business Indicator components with the simplified FINREP*

In its Consultation Paper 2024/05, the EBA proposes a detailed mapping of the Business Indicator components to the FINREP. This detailed mapping is however not consistent with the simplified version of the FINREP required from Luxembourg Less Significant banks. Those simplified FINREPs are set out in CSSF circular 14/593, as amended, for the sake of proportionality.

Can the CSSF confirm that the simplified FINREPs will be maintained for the calculation of the Business Indicator?

Market Risk

Q5 Revised boundary between trading and banking books

Which are from the CSSF perspective the main challenges posed to banks by the new trading book boundary set out in art. 104 CRR3?

Q6 Simplified standardised approach

When institutions can prove that they fulfill all conditions stipulated in Art 325a CRR3, can they automatically apply the simplified standardised approach, or is there some sort of application to file?

ESG Risks

Q7 Transition plans

Art. 76.2 CRD6 is amended to ensure that the management body develops and monitors the implementation of prudential transition plans.

What is the main difference between this CRD-based transition plan and the transition plans set out in other ESG-related EU texts such as CSRD and CSDDD? How will those plans be articulated to ensure overall coherence?

Q8 Review of the CSSF circular 21/773

Will the CSSF circular 21/773 be reviewed to incorporate the new provisions of the CRR3 / CRD6?

Governance - Fit and Proper

Q9 Management body and suitability assessment, art. 91.7 CRD6

What requirements does CRD6 introduce regarding the resources banks must allocate for training of members of the management body?

Q10 Key Function Holders and suitability assessment, art. 91a CRD6

Once the CRD6 is implemented, will the CSSF conduct a Fit and Proper assessment on all Key Function Holders?

Thank you for your attention!

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