EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Review of options and discretions

Explanatory memorandum

Revised on 22 November 2024

November 2024

Contents

1 Context of the proposed review

1.1 Overview of the current review

The European legislative framework contains a significant number of options and discretions ("O&Ds") available to competent authorities for the prudential supervision of credit institutions. With a view to ensuring consistent standards of supervision and comparability across credit institutions within the Single Supervisory Mechanism (SSM), the European Central Bank (ECB) exercises O&Ds in a harmonised manner for significant institutions (SIs) and promotes the harmonised exercise of O&Ds by national competent authorities (NCAs) in relation to less significant institutions (LSIs).

The ECB first developed its current policy framework for the exercise of O&Ds between November 2014 and April 2017, and further revised it in March 2022. The framework comprises four "O&D instruments":

- a guide[1], first published in 2016 and revised in 2022, containing specific policy guidance for Joint Supervisory Teams (JSTs) to follow when assessing individual applications from SIs in relation to the exercise of O&Ds applicable on a case-by-case basis (the "ECB Guide");
- a regulation[2], adopted in 2016 and revised in 2022[3], in which the ECB exercises several O&Ds of a generally applicable nature in respect of SIs (the "ECB Regulation");
- a recommendation[4], published in April 2017 and revised in 2022[5], addressed to NCAs in respect of the exercise of O&Ds applicable on a case-by-case basis to LSIs or for which a common approach specific to LSIs is warranted (the "ECB Recommendation");

1 ECB Guide on options and discretions available in Union law.

2 Regulation (EU) 2016/445 of the European Central Bank of 14 March 2016 on the exercise of options and discretions available in Union law (ECB/2016/4) (OJ L 78, 24.3.2016, p. 60).

3 Regulation (EU) 2022/504 of the European Central Bank of 25 March 2022 amending Regulation (EU) 2016/445 on the exercise of options and discretions available in Union law (ECB/2016/4) (ECB/2022/14) (OJ L 102, 30/03/2022, p. 11).

4 Recommendation of the European Central Bank of 4 April 2017 on common specifications for the exercise of some options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/10) (OJ C 120, 13.4.2017, p. 2).

5 Recommendation of the European Central Bank of 25 March 2022 amending Recommendation ECB/2017/10 on common specifications for the exercise of some options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2022/13) (OJ C 142, 30.3.2022, p. 1).

- a guideline[6], published in April 2017 and revised in 2022[7], addressed to NCAs concerning the exercise of O&Ds of a generally applicable nature in respect of LSIs (the "ECB Guideline").

In this consultation, the ECB is proposing several updates and amendments to the O&D instruments. Most of the proposed changes are needed because of legislative changes introduced by Regulation (EU) 2024/1923 ("CRR III")[8] and Directive (EU) 2024/1619 ("CRD VI")[9]. These acts introduced some new O&Ds into the EU legislative framework while amending some of the existing O&Ds.

The ECB is setting out policies on O&Ds with due respect, and without prejudice to the EBA's mandates to develop draft regulatory technical standards to specify how certain O&Ds should be exercised by the competent authorities.

In addition, the ECB is also proposing to introduce some changes to the ECB Guide and ECB Recommendation to reflect other legislative changes introduced since the last review in 2021 and to further clarify how the ECB exercises certain O&Ds in practice.

On 24 July 2024, the European Commission adopted a delegated regulation to defer by one year (i.e. until 1 January 2026) the date of application of FRTB.[10] The postponement will be implemented provided that the Council and Parliament do not object during a 3 month period. On 12 August 2024, the EBA published a no-action letter[11] on the trading book/banking book boundary rules and a communication covering technical questions and issues arising from the FRTB postponement. Accordingly, the parts of the ECB Guide relating to the market risk trading book and non-trading book classification exemption and the part relating to the usage of the alternative standardised approach refer to the amendments to the market risk framework introduced by the CRRIII-CRDVI package once those amendments have become applicable.

The updated version of the ECB Guide and the amendments to the ECB Regulation, the ECB Guideline and the ECB Recommendation will be revised once the comments stemming from this consultation have been assessed. Once the updated ECB Guide and the amending instruments have been approved by

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6 Guideline (EU) 2017/697 of the European Central Bank of 4 April 2017 on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/9) (OJ L 101, 13.4.2017, p. 156).

7 Guideline (EU) 2022/508 of the European Central Bank of 25 March 2022 amending Guideline (EU) 2017/697 of the European Central Bank on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/9) (ECB/2022/12) (OJ L 102, 30.3.2022, p. 34).

8 Regulation (EU) 2024/1623 of the European Parliament and of the Council of 31 May 2024 amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (OJ L, 19.6.2024, p. 1-189).

9 Directive (EU) 2024/1619 of the European Parliament and of the Council of 31 May 2024 amending Directive 2013/36/EU as regards as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks (OJ L, 19.6.2024, p. 1-68).

10 Commission Delegated Regulation (EU) XXX/XXX of 24.7.2024 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the date of application of the own funds requirements for market risk.

11 See the press release "The EBA responds to the European Commission's Delegated Act postponing the application of the market risk framework in the EU", dated 12 August 2024.

the Supervisory Board and the Governing Council, the updated version of the ECB Guide and the consolidated versions of the ECB Regulation, the ECB Recommendation and ECB Guideline will be published on the ECB's banking supervision website.

1.2 Extension of O&D policies to the supervision of LSIs

While NCAs are primarily responsible for exercising the O&Ds granted to competent authorities by Union law in relation to LSIs, the ECB promotes the consistent exercise of O&Ds in relation to both significant institutions (SIs) and LSIs, where appropriate.

As with previous iterations of the ECB's O&D instruments, when developing the current package of updates and amendments, the ECB has been guided by the principle that the same prudential rules should apply for the same risk exposure (e.g. triggered by business model and risk level). At the same time, the ECB has paid particular attention to the principle of proportionality, i.e. to what extent a different policy for LSIs may be warranted for the exercise of specific options.

The draft policies for SIs and LSIs that are subject to the current consultation have been developed in a single process in close cooperation with the NCAs. This was to ensure that ECB policies were consistent across SIs and LSIs, with a view to fostering financial integration, ensuring coherent application of high supervisory standards and maintaining a level playing field.

As specified in the Guideline and in the Recommendation, for the new or revised O&Ds, it is proposed that the policy adopted by NCAs in respect of LSIs should be the same as the policy that will be adopted by the ECB in respect of SIs. For one specific O&D, namely the possibility to determine that an institution should not be considered a small and non-complex institution (in accordance with Article 4(1)(145), point i, of the CRR), a specific treatment for LSIs has been provided in the draft amending ECB Recommendation submitted for consultation alongside this explanatory memorandum.

NCAs are recommended to interpret the relevant provisions of the ECB Recommendation mutatis mutandis, taking into consideration the allocation of competences set out in the SSM Regulation and other relevant union legislation.

2 Impact assessment, monitoring and evaluation

As noted in the explanatory memorandum published when the ECB first consulted publicly on the O&D framework in 2015, the harmonisation of most O&Ds, taken individually, does not result in a material and immediate quantitative impact. At the same time, the ECB considers that publishing the policy guidance it intends to follow when assessing individual applications from credit institutions – and, where relevant, adopting policies of a generally applicable nature – generates a significant overall benefit in terms of a simple, transparent and more consistent prudential framework.

It should be noted that the impact of the changes to the ECB Guide and the ECB Recommendation proposed in this consultation will depend in most cases on the applications received from credit institutions.

3 Legal elements of the proposal

The ECB is the competent authority in the Member States participating in the SSM for the purpose of carrying out the microprudential tasks entrusted to it by the SSM Regulation[12] (Articles 9(1) and 6(4)). In this respect, the ECB is entrusted with, and can exercise, all the powers that competent and designated authorities have under Union law, such as the power to exercise options and discretions (see Article 4(3) and recital 34 of the SSM Regulation).

The ECB has a wide latitude of discretion in exercising the O&Ds granted to competent authorities and provided for in Union law, under certain conditions and with due respect for the legitimate expectations of supervised entities, where appropriate.

For the exercise of O&Ds with general application, a regulation is an appropriate legal instrument. For the exercise of O&Ds applicable on a case-by-case basis, a supervisory decision addressed to a specific supervised entity would be the appropriate legal instrument. Nonetheless, for the latter category, the ECB Guide sets out general criteria for the exercise of case-by-case assessments with a view to ensuring a consistent application of supervisory discretion.

As regards the exercise of O&Ds for LSIs, under Article 4(3) of the SSM Regulation the ECB may, where deemed necessary, adopt, among other things, guidelines (binding legal instruments) and recommendations (non-binding legal instruments) addressed to NCAs for the prudential supervision of LSIs. In doing so it should be mindful of, among other things, its responsibility to ensure the effective and consistent functioning of the SSM.

In particular, the ECB Guideline sets out how NCAs should exercise a number of O&Ds that are generally applicable to LSIs where a specific policy rationale justifies the adoption of a uniform approach. The ECB Recommendation provides guidance to NCAs on how to individually assess certain other O&Ds, including some O&Ds for which a common simplified LSI-specific approach is warranted.

The revisions made to the O&D instruments submitted for public consultation with this document aim not only to provide greater transparency, but also to develop general guidance for a number of O&Ds that have been either introduced or amended by legislation adopted since the O&D instruments were last updated. The revision of the instruments also introduces a number of amendments based on supervisory experience of exercising certain O&Ds gathered since the instruments were last updated, as well as some amendments aimed at improving the clarity of the text.

[12] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

4 Revisions to the ECB Guide

The revised version of the ECB Guide retains the same structure as the original version: Section I introduces the purpose, legal framework, scope, content and effect of the ECB Guide as a non-binding instrument; Section II lays out the harmonised policy approach adopted by the ECB regarding O&Ds; and Section III contains a description of the follow-up actions required for a small number of O&Ds, mostly applicable on a case-by-case basis.

Some of the adjustments in the revised version of the ECB Guide are of an editorial nature and are intended to improve the consistency of the document with regard to legal references in the light of the introduction of new amending legislation. In some cases, adjustments are aimed at improving the alignment between the ECB Guide and the underlying legislation.

Explanations for the substantive changes introduced in the revised version of the ECB Guide are set out in the remainder of this section.

4.1 Section II, Chapter 1: Consolidated supervision and waivers of prudential requirements

- **Derogation from the application of prudential requirements on an individual basis (Article 7 of the CRR)**

The scope of the legal opinion required for prudential waivers under Article 7(3) of the CRR has been clarified. The ECB expects the legal opinion to cover all subsidiaries that are included in the scope of prudential consolidation. This notwithstanding, the ECB may be satisfied if certain undertakings are not included in the legal opinion provided that the granting of the waiver is not and will not be justified on the basis of resources coming from those undertakings.

- **Methods for consolidation in the case of related undertakings within the meaning of Article 22(7) of Directive 2013/34/EU (Article 18(3) of the CRR in conjunction with Article 2 of Commission Delegated Regulation (EU) 2022/676)**

- **Consolidation in the case of participations or capital ties other than those referred to in Article 18(1) and (4) of the CRR (Article 18(5) of the CRR in conjunction with Article 4 of Commission Delegated Regulation (EU) 2022/676)**

- **Consolidation in the case of significant influence and single management (Article 18(6) of the CRR in conjunction with Articles 5 and 6 of Commission Delegated Regulation (EU) 2022/676)**

- **Consolidation in the case of step-in risk (Article 18(8) of the CRR in conjunction with Article 7 of Commission Delegated Regulation (EU) 2022/676)**

The provisions on methods for consolidation have been updated to align with provisions of Commission Delegated Regulation (EU) 2022/676[13].

In addition, following amendments introduced by the CRR III, ancillary services undertakings qualify as financial institutions pursuant to Article 4(1), point (26), of the CRR. Thus, the separate references to ancillary services undertakings have been removed as they are now redundant.

Finally, for Article 18(5) of the CRR, it is clarified that the ECB will generally expect credit institutions to apply the method of consolidation provided for under the applicable accounting framework. Where justified, the ECB may impose the use of a different method, e.g. the equity method, proportional consolidation or full consolidation.

- **Exclusion from consolidation (Article 19(2) of the CRR)**

Following amendments introduced by CRR III, ancillary services undertakings qualify as financial institutions pursuant to Article 4(1), point (26), of the CRR. Thus, the separate references to ancillary services undertakings have been removed as they are now redundant.

In addition, a minor textual edit has been introduced to clarify the ECB's expectations concerning valuation methods.

- **Valuation of assets and off-balance-sheet items – use of International Financial Reporting Standards (IFRS) for prudential purposes (Article 24(2) of the CRR)**

The policy guidance has been updated to clarify that the ECB may consider exercising the option set out in Article 24(2) on a case-by-case basis, if duly justified from a supervisory perspective.

The ECB takes note of the increasing importance of information reported at an individual bank level, which could be further amplified by data reporting integration initiatives launched at European level going forward and which increases the need for the application of one coherent accounting standard for prudential purposes across all reporting entities of a group. Depending on the evolution of such initiatives, and with due regard for the proportionality

[13] Commission Delegated Regulation (EU) 2022/676 of 3 December 2021 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the conditions in accordance with which consolidation is to be carried out in the cases referred to in Article 18(3) to (6) and Article 18(8) of that Regulation (OJ L 123, 26.4.2022, p. 1).

principle, the ECB may consider exercising the option set out in Article 24(2) of the CRR to require the valuation of assets and off-balance-sheet items and the determination of own funds in accordance with IFRS in some cases where the applicable national accounting framework requires the use of n-GAAP. Depending on the design of these integrated reporting frameworks, such decisions could, for example, be aimed at increasing consistency in accounting standards used for prudential purposes within banking groups and, as such, be addressed to certain entities that apply n-GAAP for prudential purposes at an individual level while IFRS is used for prudential purposes at consolidated group level.

If any such decisions are taken, the ECB may consider the application of a transitional period for the full implementation.

- **Discretion to exclude financial holding companies and mixed financial holding companies from the perimeter of consolidation (Article 21a(4a) of the CRD)**

Guidance has been introduced in relation to the discretion for competent authorities to exclude financial holding companies and mixed financial holding companies from the perimeter of consolidation. The guidance specifies the factors that the ECB will assess to determine whether (i) the exclusion of financial holding companies and mixed financial holding companies from the perimeter of consolidation may affect the effectiveness of the supervision of the subsidiary credit institution or the group; and (ii) the financial holding company or mixed financial holding company is making recourse to substantial leverage.

4.2 Section II, Chapter 2: Own funds

- **Classification of subsequent issuances as Common Equity Tier 1 (CET1) instruments (Article 26(3) of the CRR)**

The policy guidance has been amended to clarify that, in certain circumstances, a notification may be considered complete even if certain documents mentioned in the guidance have not yet been provided. The ECB Guide has also been revised to further clarify the circumstances under which the ECB may consider capital instruments issued against contributions in kind as a subsequent issuance with provisions that are substantially the same as the provisions governing previous issuances for which the institution has already received permission.

- **Deduction of holdings of insurance (Article 49(1) of the CRR)**

The policy guidance has been updated to specify that the permission not to deduct holdings within the context of Article 49(1) of the CRR should cover all own funds-equivalent instruments and not only CET1-equivalent instruments.

In cases where permissions for non-deduction have been granted by a national competent authority prior to 4 November 2014, and those permissions limit the non-deduction to CET1-equivalent instruments only, the ECB will ask credit institutions to apply for a permission covering all own funds-equivalent instruments; otherwise, it will proceed with the revocation of the existing permissions. In order to allow affected credit institutions time to adjust to the revised approach, the ECB will provide for an appropriate transition period during which those credit institutions may continue to apply the current approach.

- **Deduction of holdings of financial sector entities (Article 49(2) of the CRR)**

Regulation (EU) 2022/2036 (the "Daisy Chain Regulation")[14] amended Article 49(2) of the CRR by introducing an additional sub-paragraph. The ECB Guide has been revised to bring it into alignment with the amended legislation.

- **General prior permission for reduction of own funds (Article 78(1) of the CRR)**

The ECB Guide has been updated to clarify the cross reference to paragraph 8 of Section II, Chapter 2 of the ECB Guide. In particular, Article 78(1), second sub-paragraph, of the CRR specifies that for CET1 instruments the predetermined amount of the reduction shall not exceed 10% of the amount by which CET1 capital exceeds the sum of CET1 capital requirements laid down in the CRR, CRD and Bank Recovery and Resolution Directive (BRRD)[15] added to a margin that the competent authority considers necessary. If an institution uses part of its CET1 capital in excess of its CET1 requirements to meet any non-CET1 requirements, this amount increases the margin considered necessary by the ECB.

- **Excess capital margin requirement for own funds reductions without replacement under Article 78(1), point (b), of the CRR**

The ECB Guide has been updated to clarify the factors the ECB assesses for the purpose of determining the excess margin required in Article 78(1), point (b), of the CRR. Further editorial changes have also been made to footnote 34 in paragraph 8 of Section II, Chapter 2 of the ECB Guide to enhance its clarity.

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14 Regulation (EU) 2022/2036 of the European Parliament and of the Council of 19 October 2022 amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institutions with a multiple-point-of-entry resolution strategy and methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities (OJ L 275, 25.10.2022, p. 1).

15 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

- **Reduction of own funds for mutuals, savings institutions and cooperative societies under Article 78(3) of the CRR**

The guidance with regard to limitations on redemptions of capital instruments, as envisaged in Articles 10 and 11 of Commission Delegated Regulation (EU) No 241/2014,[16] has been updated to reflect the possibility that, following such a redemption, an institution could potentially be in breach of its leverage ratio requirements, minimum requirements for own funds and eligible liabilities (MREL) or total loss-absorbing capacity (TLAC) requirements. Therefore, the guidance has been updated to reflect the ECB's expectation that institutions determine the extent of limitations on redemptions by considering their CET1, Tier 1, and total capital and eligible liabilities also in relation to these requirements and not only the requirements already mentioned in the current version of the ECB Guide.

- **Reduction of Additional Tier 1 or Tier 2 instruments and/or related share premium accounts during the five years following their date of issuance (Article 78(4) of the CRR)**

The ECB Guide has been updated – in relation to the discretion of the competent authorities to permit institutions to call, redeem, repay or repurchase Additional Tier 1 or Tier 2 instruments – to include the term "related share premium accounts", which was introduced by Regulation (EU) 2019/876.[17]

- **Inclusion of minority interests in qualifying Additional Tier 1 and qualifying Tier 2 capital at a consolidated level (Articles 84(1), point (a)(ii), 85(1), point (a)(ii), and 87(1), point (a)(ii), of the CRR)**

The ECB Guide has been updated to set out the ECB's expectations regarding the approach that credit institutions take when quantifying the amount of consolidated CET1 capital relating to subsidiaries in third countries that is required on a consolidated basis. Specifically, the ECB sets out its expectation that supervised entities should calculate the amount by using the lower of the relevant requirements laid down in the CRR/CRD and the applicable local consolidated requirements of the third countries. Such an approach is consistent with the Basel standards, according to which the lowest applicable requirements should be used. The ECB Guide also specifies that the ECB also expects credit institutions to use the same approach for Tier 1 and total capital.

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16 Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions (OJ L 74, 14.3.2014, p. 8).

17 Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p. 1).

- **Derogation from the "lower of the two requirements" principle for minority interests and AT1 and Tier 2 instruments issued by subsidiaries (Articles 84(1), point (a), 85(1), point (a), and 87(1), point (a), of the CRR)**

The ECB has also set out its expectations concerning the factors it will consider when assessing whether additional amounts of minority interests generated by derogating from the "lower of the two requirements" principle are available to absorb losses at consolidated level. Since capital held by third-party investors covers the losses suffered by the issuing entity only, in order to make it possible for this capital to also absorb losses at consolidated level, an automatic intragroup transfer of resources would be needed.

4.3 Section II, Chapter 3: Capital requirements

- **Boundary between the trading book and the non-trading book (Articles 104(4) and 104(5) of the CRR)**

The ECB Guide has been amended to set out the ECB's expectations in relation to the assignment of positions to the trading book or the non-trading book. The ECB Guide also sets out the factors that the ECB will consider when assessing requests to assign a position in an instrument referred to in points (d) to (i) of Article 104(2) of the CRR to the non-trading book, in accordance with Article 104(4) of the CRR, and when assessing requests to assign a position in an instrument referred to in point (i) of Article 104(3) of the CRR to the trading book, in accordance with Article 104(5) of the CRR.

- **Calculation of risk-weighted assets (RWA) for intragroup exposures (Article 113 (6) of the CRR)**

The reference to ancillary services undertakings has been removed from the Guide since, following the amendments introduced by the CRR III, such undertakings now qualify as financial institutions by definition.

- **Equity exposures subject to legislative programmes (Article 133(5) of the CRR)**

Policy guidance has been added to the ECB Guide specifying the criteria that the ECB will consider when assessing requests for permission to apply a risk weight of 100% to equity exposures subject to legislative provisions. The guidance reflects the ECB's view that the reduction in risk coverage that comes from applying a lower risk weight to such exposures should be warranted by a commensurate reduction in loss risk to the applicant credit institution on account of the equity exposure being subject to legislative programmes. By way of example, taking the calibration of CRR risk weights to the minimum 8% capital ratio as a benchmark, the loss risk reduction should be commensurate with a drop from 20% of the exposure value (as implied by a 250% risk weight) to 8% of the exposure value (as implied by a

100% risk weight). The ECB will assess each application on a case-by-case basis taking into account the specific details of each legislative programme.

- **Maturity of exposures (Article 162 of the CRR)**

The policy guidance in the original version of the ECB Guide in relation to the discretion to determine the conditions for the use of the maturity value has been deleted because the legal basis for the exercise of that discretion has been removed from the CRR.

- **Securitisation – significant risk transfer (Article 244(2) and (3) of the CRR and Article 245(2) and (3) of the CRR)**

The policy guidance has been revised to reflect developments in the ECB's approach to significant risk transfer assessments. The revisions also bring the guidance into alignment with the European Banking Association (EBA) Report on significant risk transfer (EBA/Rep/2020/32)[18] and the EBA Guidelines on Significant Credit Risk Transfer (EBA/GL/2014/05)[19].

The extension of the policy guidance to LSIs on how to assess significant risk transfer is without prejudice to any notification processes and requirements NCAs have implemented for SRT securitisations of LSIs in accordance with paragraph 11 of the EBA/GL/2014/05.

- **Own estimates of volatility adjustments (Article 225(2), point (e), of the CRR)**

The policy guidance in relation to own estimates of volatility adjustments has been deleted because the legal basis for the exercise of that discretion has been removed from the CRR.

- **Operational risk – interest, leases and dividends component of the business indicator component (Article 314(3) of the CRR)**

Policy guidance has been set out explaining the circumstances in which the ECB may grant permission for credit institutions to apply the derogation to calculate a separate interest, leases and dividends component for specific subsidiaries in accordance with Article 314(3) of the CRR.

Regarding the condition laid down in Article 314(3), point (b), that a significant proportion of the subsidiaries' retail or commercial banking activities comprises loans associated with a high probability of default, the ECB would ordinarily expect more

[18] EBA Report on significant risk transfer in securitisation under Articles 244(6) and 245(6) of the Capital Requirements Regulation (EBA/Rep/2020/32).

[19] EBA Guidelines on Significant Credit Risk Transfer relating to Articles 243 and 244 of Regulation 575/2013 (EBA/GL/2014/05).

than 50% of the subsidiary's relevant exposures to be at least twice that of comparable exposures of the parent credit institution.

(On 22 November 2024 the ECB made a correction to the paragraph below, amending the description of the proposed policy concerning Article 314(3) of the CRR.)

In addition, the ECB has specified its expectation that a credit institution would typically fulfil the condition laid down in Article 314(3), point (c) – namely that the use of the derogation provides an appropriate basis for calculating its own funds requirements for operational risk – only where its historical loss component does not exceed its business indicator component and where the ratio of operational losses to operational risk capital requirements for the subsidiary on a standalone basis is not greater than that of the group.

- **Operational risk – basic indicator approach (Article 315(3) of the CRR) and standardised approach (Article 317 of the CRR) with regard to own funds requirements**

The basic indicator approach set out in Article 315 of the CRR has been repealed, while Article 317 has been replaced. Therefore the corresponding policy guidance in relation to these articles has been deleted.

- **Market risk – internal review of usage of the alternative standardised approach (ASA) to the satisfaction of the competent authority and frequency of such review (Articles 325c(5), 325c(6), first sub-paragraph, and 325c(7) of the CRR)**

The ECB Guide has been revised to set out the ECB's expectations in assessing the fulfilment of the requirements of Article 325c of the CRR, including the independent review process of credit institutions in accordance with Article 325c(5) of the CRR, the option to reduce the frequency of this review to once every two years in accordance with Article 325c(6), second sub-paragraph, of the CRR, and the supervisory verification of the integrity of implementation of the ASA in accordance with Article 325c(7) of the CRR.

- **Market risk – permission to use the alternative definition of sensitivities for delta and vega risks (Article 325t(5) and (6) of the CRR)**

The ECB Guide has been updated to set out the ECB's expectations in relation to permissions for credit institutions to use alternative definitions of delta and vega risk sensitivities.

The ECB developed a supervisory assessment process for the application of alternative delta and vega sensitivities, when Fundamental Review of the Trading Book reporting requirements came into force in September 2021 for the ASA. The process introduced a quantitative materiality criterion, set at a standard level of 10% on risk class level. Based on the insights from this field-tested process, the ECB intends to base the assessment of the materiality of the difference between credit institutions' internal and regulatory definitions of qualitative criteria. This implies a

shift in focus away from a quantitative comparison of regulatory and alternative sensitivity definitions towards a qualitative view that emphasises methodological consistency of the sensitivity definitions.

- **Credit valuation adjustment (CVA) risk – permission to use the alternative definition of sensitivities for delta and vega risk (Article 383b(2) of the CRR)**

The ECB Guide has been updated to set out the ECB's expectations in relation to permissions for credit institutions to use alternative definitions of delta and vega risk sensitivities in the calculation of the own funds requirements of a trading book position when applying the standardised approach for CVA risk calculation.

- **CVA risk – use of internal ratings to determine credit quality steps for SA-CVA and BA-CVA (Articles 383o and 384(2) of the CRR)**

The ECB Guide has been updated to set out the ECB's expectations in relation to permissions for credit institutions to use internal ratings for the determination of credit quality steps when applying both the standardised approach (SA) and basic approach (BA) for CVA risk calculation.

4.4 Section II, Chapter 4: Institutional protection schemes

- **Deduction of holdings in the presence of institutional protection schemes (IPSs) (Article 49(3) of the CRR)**

References to implementing technical standards on supervisory reporting were updated to reflect the publication of Commission Implementing Regulation (EU) 2021/451[20].

- **Recognition of IPSs for prudential purposes (Article 113(7) of the CRR)**

The policy guidance on the recognition of IPSs for prudential purposes has been revised on the basis of supervisory experience and to bring the text into line with the amendments introduced by CRR III.

References to ancillary services undertakings have been removed because these undertakings now qualify, by definition, as financial institutions.

As regards the supervisory assessment of whether an IPS can provide sufficient support in the event that a member institution faces severe financial constraints, the policy guidance has been adjusted to clarify that IPS support measures can be part of the IPS member's recovery options.

Regarding the condition laid down in Article 113(7), point (b), of the CRR that arrangements are in place which ensure that the IPS is able to grant the support

[20] Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014 (OJ L 97, 19.3.2021, p. 1).

from funds readily available to it, the policy guidance has been updated to reflect that an IPS should have sufficient intervention rights if it is required to provide support. This revision reflects the ECB's view that an IPS should not be impeded in restructuring a supported bank, for instance by past owners retaining an ability to influence decision-making.

The guidance in relation to Article 113(7), point (b), has also been updated to include the ECB's expectations around the time frames for decision-making in the case of capital and liquidity support measures. Moreover, the ECB has elaborated on its expectations regarding the stress tests that IPSs should conduct at regular intervals to quantify potential capital and liquidity support measures. Finally, the guidance on IPSs that are recognised as deposit guarantee schemes (DGSs) has been clarified to highlight that the collection of funds according to the respective national transposition of the DGS Directive[21] is not necessarily sufficient for an IPS to be deemed to have met the condition laid down in Article 113(7), point (b).

The ECB's expectations in relation to Article 113(7), point (c), of the CRR concerning systems for the monitoring and classification of risk have been revised to specify that the monitoring of activities should contain a forward-looking element in order to anticipate the impact of a potentially deteriorating macroeconomic environment. In addition, it has been specified that IPS systems for categorising members should allow for timely implementation of support measures based on clear indicators. An expectation that an IPS should have the possibility to commission independent auditors to conduct inspections of its members has also been introduced.

As regards Article 113(7), point (f), of the CRR concerning processes for exiting or ending an IPS, the ECB has clarified its expectations: (i) on the exceptional circumstances in which a notice period of less than 24 months may be agreed; (ii) of continued compliance with regulatory requirements both by individual members exiting the IPS and the IPS itself; and (iii) on the need for IPS members to maintain an understanding of IPS-related prudential reliefs.

As regards Article 113(7), point (i), of the CRR, that the adequacy of the systems referred to in points (c) and (d) is approved and monitored at regular intervals by the relevant competent authorities, the revised ECB Guide specifies that it is important that both authorities – the ECB and the NCA concerned – have access to the same information needed to properly assess the risk situation of the affected IPS member.

[21] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.06.2014, p. 149).

4.5 Section II, Chapter 9: General requirements for access to the activity of credit institutions

- **Discretion to allow a third-country group to have two intermediate EU parent undertakings in the EU (Article 21b of the CRD)**

The ECB Guide has been updated to reflect ECB practices and to bring it into conformity with the EBA opinion on the set-up and operationalisation of the intermediate parent undertaking (IPU) requirement. In addition, a reference to the FAQ on the IPU requirement[22] that has been published on the ECB's banking supervision website has been included.

4.6 Section II, Chapter 11: Governance arrangements and prudential supervision

- **Combining the functions of chair and CEO (Article 88(1), point (e), of the CRD)**

The policy guidance has been deleted because the legal basis for the exercise of this discretion has been removed from the CRD.

4.7 Section III: O&Ds requiring follow-up actions

Section III of the ECB Guide sets out a high-level policy direction for certain O&Ds where specific follow-up actions or further assessment are envisaged. Some of the existing guidance in this section has been deleted or relocated to Section II of the ECB Guide in the light of regulatory developments that have occurred since the last update of the ECB Guide in 2022. The ECB has also decided to introduce high-level guidance in relation to certain new O&Ds, pending possible further policy development in due course.

- **Methods of consolidation (Article 18(3), (5), (6) and (8) of the CRR)**

Following the publication of Commission Delegated Regulation (EU) 2022/676, the previous guidance on methods of consolidation has been revised and relocated to Section II of the ECB Guide (see Section 4.1).

- **Discretion to not qualify an entity as a financial holding company (Article 4(1), point (20), of the CRR)**

The ECB may consider it necessary to make use of this discretion on the basis of a case-by-case assessment and having due regard to the EBA consultation required by Article 4(1) point (20) of the CRR. Article 18(10) of the CRR instructs the EBA to draft a report on the completeness and appropriateness of the CRR definitions. The

[22] See the FAQs on the intermediate EU parent undertaking requirement on the ECB website.

ECB will consider the need to publish further specifications once the EBA has published its report.

- **Operational risk – Business Indicator: Calculation of the services component for IPSs (Article 314(5) of the CRR)**

According to Article 314(5) of the CRR, institutions that are members of an institutional protection scheme meeting the requirements of Article 113(7) of the CRR may, subject to the prior permission of the competent authorities, calculate the services component of the business indicator net of any income received from, or expenses paid to, institutions which are members of the same IPS. The same article provides that such calculations should be allowed only to the extent that the institutional protection scheme has at its disposal suitable and uniformly stipulated systems for the monitoring and classification of operational risks. It also provides that any losses resulting from the related operational risks are subject to mutualisation across institutional protection scheme members.

The ECB intends to determine its policy and potentially develop specifications pertaining to what would be “suitable and uniformly stipulated systems for the monitoring and classification of operational risks”, as well as the expectation regarding the “mutualisation across institutional protection scheme members” based on the EBA draft RTS and Guidelines to be issued pursuant to Articles 314(9), 323(2), 317(9), and 317(10) of the CRR.

5 Amendments to the ECB Regulation

- **Default of an obligor (Article 178(1)(b) of the CRR)**

The CRR III deleted the second part of Article 178(1), point (b), of the CRR. Hence, the corresponding article (Article 4) has been deleted from the ECB Regulation.

- **Transitional arrangements for External Credit Assessment Institutions (ECAI) credit assessments of institutions (Article 495e of the CRR)**

The ECB is generally of the view that, consistent with the final Basel III framework, the credit assessments used within the SA for credit risk should not incorporate assumptions of implicit government support. However, to support the smooth introduction of this regulatory change, the ECB sees the need to provide additional time for ECAIs to develop procedures and processes for producing credit assessments that exclude such assumptions. Therefore, the ECB intends to exercise until 1 July 2026 the option provided in Article 495e of the CRR to allow institutions to continue using ECAI credit assessments in relation to institutions which incorporate assumptions of implicit government support.

6 Amendments to the ECB Recommendation

- **Exclusion of an institution from the definition of small non-complex institution (Article 4(1), point (145)(i), of the CRR)**

With a view to increasing the degree of harmonisation of practices across the NCAs participating in the SSM, the ECB Recommendation has been amended to specify that where an NCA has assessed an LSI that is also a small and non-complex institution (SNCI) to be “high risk” for more than four quarters, the NCA should consider whether it remains appropriate for the credit institution to continue being deemed an SNCI. While NCAs may deem that such institutions, on account of their risk profile, should no longer be considered SNCIs, the ECB is of the view that this should not be an automatic consequence of an entity being deemed high risk for more than four quarters. Rather, NCAs are recommended to perform case-by-case assessments and to exercise the option provided for in Article 4(1), point (145)(i), of the CRR only where appropriate after considering the specific circumstances of each institution.

7 Amendments to the ECB Guideline

- **Article 4 of the ECB Guideline: (Article 178(1), point (b), of the CRR)**

The CRR III deleted the second part of Article 178(1), point (b), of the CRR. Hence, the corresponding article (Article 4) has been deleted from the ECB Guideline.

Errata

Location	Original sentence	New sentence	Date of change	Reason for change
Chapter 4.3, page 14	In addition, the ECB has specified its expectation that a credit institution would typically fulfil the condition laid down in Article 314(3), point (c) – namely that the use of the derogation provides an appropriate basis for calculating its own funds requirements for operational risk – only where its historical loss component exceeds its business indicator component and where the ratio of operational losses to operational risk capital requirements for the subsidiary on a standalone basis is greater than that of the group.	In addition, the ECB has specified its expectation that a credit institution would typically fulfil the condition laid down in Article 314(3), point (c) – namely that the use of the derogation provides an appropriate basis for calculating its own funds requirements for operational risk – only where its historical loss component does not exceed its business indicator component and where the ratio of operational losses to operational risk capital requirements for the subsidiary on a standalone basis is not greater than that of the group.	22 November 2024	Correction of a mistake

Postal address 60640 Frankfurt am Main, Germany
Telephone +49 69 1344 0
Website www.ecb.europa.eu