EBA/RTS/2024/17

28 June 2024

Final Report

Draft Regulatory Technical Standards

On conditions and indicators that EBA shall use to determine whether extraordinary circumstances have occurred for the purposes of Articles 325az(5) and 325bf(6) CRR

Contents

1. Executive Summary

Article 325az(10) of Regulation (EU) No 575/2013 ('CRR') mandates the EBA to specify the conditions and indicators that the EBA shall use to determine whether extraordinary circumstances, under which competent authorities may soften or waive the application of certain requirements for the use of internal models for market risk, have occurred.

The draft RTS presented in this final report establish a high-level framework for identifying the occurrence of extraordinary circumstances, setting out conditions that need to be met and indicators that could support the identification of extraordinary circumstances.

More specifically, these RTS set out that only a situation of cross-border financial market stress, or a regime shift, can qualify as a situation of extraordinary circumstances, and only subject to the additional condition that this stress or regime shift impacts the validity or suitability of the results of the back-testing or the profit and loss attribution test (PLAT).

In order to assess whether the two conditions mentioned are met, these draft RTS specify that, among other factors and indicators reflective of the nature of the stress or regime shift, the levels of volatility and correlations should be assessed. These RTS also require taking into consideration, how quickly the financial stress manifested or the regime shift happened.

Next steps

The draft regulatory technical standards will be submitted to the Commission for endorsement following which they will be subject to scrutiny by the European Parliament and the Council before being published in the Official Journal of the European Union. The technical standards will apply from 20 days after their entry into force.

2. Background and rationale

1. In accordance with Articles 325bf(6) and 325az(5) of Regulation (EU) No 575/2013 ('CRR'), as amended by Regulation (EU) 2024/1623 ('CRR3'), competent authorities may permit institutions to derogate from certain requirements of the regulatory framework for the use of internal models, or apply a softer version of those requirements, where a situation of extraordinary circumstances has occurred. Such a tool avoids the need to make cumbersome changes to the legislative framework, like the changes to the Prudent Valuation framework made[1], or the temporary possibility to exclude certain overshooting introduced[2], during the COVID-19 crisis, every time circumstances are deemed to be too extraordinary to continue applying the regulatory requirements in full.

2. In accordance with Article 325az(9) CRR, the occurrence of extraordinary circumstances shall be determined by the EBA, which must issue an opinion to that effect.

3. The regulatory technical standards presented in this final report establish a high-level framework for identifying a situation of extraordinary circumstances, by setting out conditions that need to be met and indicators that the EBA shall use to determine whether extraordinary circumstances have occurred.

4. If permissions to derogate from the regulatory framework were granted frequently, the substance of that regulatory framework would be undermined, and the framework would no longer serve its purpose. The Basel Committee on Banking Supervision (BCBS) specified in its standards for market risk[3], that a derogation should only be granted in most extraordinary, systemic circumstances, that affect several institutions. In line with the principle stipulated by the BCBS, and with a view of operationalising that principle, the draft RTS presented in this final report foresee that extraordinary circumstances could be recognised only where there is a situation of significant cross-border financial market stress, or a major regime shift associated with a similar level of stress (e.g. a liquidity crisis), that are capable of rendering the outcome of the back-testing and profit and loss attribution requirements inappropriate.

5. The BCBS framework also clearly stipulates that extraordinary circumstances are meant to address situations of systemic stress, i.e. expected to have an impact on several types of portfolios. This is reflected in the draft RTS presented in this final report. In particular, the fact that the RTS focus on financial market stress and major regime shifts ensures that the extraordinary circumstances framework cannot be triggered by the situation and specificities of a single institution.

[1] See EBA statement on the application of the prudential framework on targeted aspects in the area of market risk in the COVID-19 outbreak and Regulation (EU) 2020/866

[2] Article 500c CRR, introduced by Regulation (EU) 2020/873 ('CRR quick fix')

[3] MAR32 - Internal models approach: backtesting and P&L attribution test requirements (bis.org)

6. Extraordinary circumstances may impact different institutions in a different manner and to a different extent. Once a situation of extraordinary circumstances is recognised in accordance with the provisions of the RTS, the competent authorities should, to the extent possible, analyse the impact on the different institutions under their supervision. Based on that analysis, a competent authority may, but does not have to, grant its supervised entities the particular derogations from the existing regulatory framework foreseen by the CRR: the competent authority may allow an institution to continue using the AIMA for a trading desk despite that desk failing the PLAT or not meeting the back-testing requirements (Article 325az(5) and (9) CRR3), to limit the calculation of the add-on to that resulting from overshootings under the back-testing of hypothetical changes (Article 325bf(6), second subparagraph, point (a), CRR3), and/or to exclude the overshootings evidenced by the back-testing of hypothetical or actual changes from the calculation of the add-on (Article 325bf(6), second subparagraph, point (b), CRR3). If the competent authority decides to grant such a permission, it should tailor the permission to the particular situation of that institution; among others, to ensure that known model deficiencies keep being accounted for and continue to be remedied and/or capitalised.

7. Besides defining the meaning of ‘extraordinary circumstances’, the RTS presented in this final report also list the (minimum set of) factors and indicators that the EBA shall assess to identify extraordinary circumstances.

8. A situation associated with a degree of stress that is sufficiently extraordinary to consider softening or waiving the applicable requirements is one where, at the very least, the volatility observed in the market increases significantly, and correlations differ significantly from those observed under ordinary circumstances. For that reason, these draft RTS envisage that two of the more important indicators to take into account when deciding whether there is a situation of extraordinary circumstance, are volatility indicators, including indicators of realised volatilities, and correlation indicators.

9. However, a significant increase of the volatility, and significant changes to observed correlation patterns, as such and on their own are not sufficient to declare a situation as severe and extraordinary; the boundary between increased volatility/correlation levels that can be expected and should, commonly, be accounted for in the normal course of business, and extreme volatility/correlation levels that characterize the situations a one of a crisis, is blurred. For that reason, a decision to trigger the ‘extraordinary circumstances’-framework should also be based on other indicators and factors, that suitably reflect the source, nature and impact of the financial market stress or the regime shift. As the type and extent of stress and crises are commonly not predictable, the RTS presented in this final report do not specify in further detail what kind of indicators and factors could be considered.

10. Both the back-testing in accordance with Article 325bf CRR, and the profit and loss attribution test (PLAT) performed in accordance with Article 325bg CRR consider the period of 250 business days, and any development therein, preceding the reference date of the assessment. Thus, a period of stress, irrespective of its length, will impact the results of the back-testing and PLAT performed during the stress period itself and up to a year after the end of the stress period. In case of the back-

testing, only relevant overshootings observed during the stress period itself should be possible candidates for exclusion in accordance with Article 325bf(6) CRR3. In case of the PLAT, the failure to meet the PLAT (i.e. having the desk classified as red or amber) at any assessment date during the stress period itself or the twelve months following it might be considered a possible case for granting a permission in accordance with Article 325az(9) CRR3. In terms of time and duration of application, the competent authority’s permission may thus also cover, to some extent, a period after the stress subsided.

11. In the light of this, these RTS defines a period of extraordinary circumstances as a period, which may not cover just the stress period itself, but a combination of the stress period and the subsequent ‘impact period’ of up to 250 business days.

3. Draft regulatory technical standards

COMMISSION DELEGATED REGULATION (EU) …/…

of XXX

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the conditions and indicators that EBA shall use to determine whether extraordinary circumstances have occurred for the purposes of Articles 325az(5) and 325bf(6)

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012[4], and in particular Article 325az(9), fifth subparagraph, thereof,

Whereas:

(1) According to the Basel Committee on Banking Supervision (BCBS) standards for market risk, competent authorities may permit institutions, in exceptional situations, to derogate from the compliance with certain requirements of the alternative internal models approach, in relation to the back-testing and the profit and loss attribution test (PLAT). In line with that principle, extraordinary circumstances should be recognised only in a situation of significant cross-border financial market stress, or a major regime shift, that materially affects institutions across the Union.

(2) Extraordinary circumstances should also only be recognised to the extent that institutions are not able to meet the requirements of Article 325bf(3) (back-testing) or 325bg (PLAT) of Regulation (EU) No 575/2013, because of events that are beyond their control and breaching those requirements is not the result of deficiencies of the internal model.

(3) Both the back-testing and the PLAT are carried out on data for the 250 business days preceding the date where the respective test is performed. Thus, extraordinary circumstances should be recognised where a period of financial market stress or of a regime shift fully or partially included in that 250 business days-interval produce exceptions that are not a result of deficiencies of the internal model.

(4) The features of a crisis leading to financial market stress, or of a regime shift, are unique to every such crisis or regime shift. Therefore, ex ante, it would not be appropriate to lay out in a prescriptive manner an exhaustive set of indicators or

[4] OJ L 176, 27.06.2013, p. 1, ELI: http://data.europa.eu/eli/reg/2013/575/oj

factors, that would be deemed to always adequately capture the nature and intensity of the financial market stress or regime shift at hand. However, based on past experience, a significant increase of the level of volatility, changes in correlation levels, and the fact that the financial market stress or regime shift manifests very quickly and suddendly should be considered common traits of crisis situations. Still, a sudden increase of the level of volatility, or changes in volatility levels, on their own, may not be sufficient to characterise a situation as one of financial market stress or of a regime shift and, therefore, should not automaticaly lead to the recognition of extraordinary circumstances referred to in Article 325az(5) and Article 325bf(6) of Regulation (EU) No 575/2013.

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

(6) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[5],

HAS ADOPTED THIS REGULATION:

Article 1

Conditions for extraordinary circumstances and factors and indicators to be assessed

1. Any period of 250 business days that is considered for the assessment of the compliance with the back-testing requirements set out in Article 325bf of Regulation (EU) No 575/2013 or the profit and loss attribution requirements in accordance with Article 325bg of that Regulation shall be deemed a period of extraordinary circumstances, where it includes a period in relation to which the EBA has determined that all of the following conditions are met:

   (a) a significant cross-border financial market stress has been observed or a major regime shift has taken place;

   (b) the financial market stress or major regime shift referred to in point (a) is likely to render the outcome of the back-testing performed in accordance with Article 325bf of Regulation (EU) No 575/2013 or of the profit and loss attribution test performed in accordance with Article 325bg of that Regulation not representative of the adequacy of the internal model for the calculation of own funds requirements, including when those tests produce results that do not relate to deficiencies in the internal model.

[5] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12–47.), ELI: http://data.europa.eu/eli/reg/2010/1093/oj

2. In order to assess whether the conditions specified in paragraph 1 are met, the EBA shall take factors and indicators that are representative of or reflect the nature of the stress or regime shift into account, including all of the following:

   (a) the analysis of volatility indices, and indicators of realised volatilities, deemed to be suitable to capture the nature of the financial market stress or regime shift;

   (b) the assessment of whether the financial market stress or major regime shift led to volatility levels that are comparable to, or exceed, those observed during the global financial crisis or the COVID-19 pandemic, or entailed a relative change in the level of the volatility levels that is comparable to the change observed during that crisis or that pandemic;

   (c) the assessment of how quickly the financial stress manifested or the regime shift happened;

   (d) the analysis of relevant correlations and correlation indicators, including the assessment of whether a sudden and significant change of the level of the correlation was observed.

   For the purposes of the first subparagraph, point (c), with regard to the back-testing performed in accordance with Article 325bf of Regulation (EU) No 575/2013, it shall be taken into particular consideration, whether and to which extent the statistical characteristics observed during the period of financial market stress or regime shift differ from the those observed during the reference period used for the calibration of the value-at-risk-number in accordance with Article 325bf of that Regulation.

Article 2

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

4. Accompanying documents

4.1 Draft cost-benefit analysis / impact assessment

As per Article 10 of Regulation (EU) No 1093/2010 (EBA Regulation), any draft regulatory technical standards (RTS) developed by the EBA shall be accompanied by an Impact Assessment (IA), which analyses 'the potential related costs and benefits'.

This analysis presents the IA of the main policy options included in this Consultation Paper on these Draft Regulatory Technical Standards on extraordinary circumstances for continuing the use of an internal model under Article 325az(9) CRR ('these draft RTS'). The analysis provides an overview of the identified problem, the proposed options to address this problem as well as the potential impact of these options. The IA is high-level and qualitative in nature.

A. Problem identification

To calculate their market risk own funds requirements for the portfolio of some or all positions assigned to trading desks, institutions may use, subject to a permission from their respective competent authorities, an internal model approach as described in Part Three, Title IV, Chapter 1b of the CRR. Competent authorities shall grant permission to those institutions to use their internal model approach, provided that requirements stipulated in Article 325az of the CRR are met. Amongst those requirements, there are a back-testing ('BT') and a profit and loss attribution test ('PLAT') requirement[6]. Where a trading desk of an institution does not meet the BT or PLAT requirements, the own funds requirements for that desk have to be calculated on the basis of the Standardised Approach set out in Part Three, Title IV, Chapter 1a, CRR; where the institution or a desk meets the BT requirements, but does not perform well, it is subject to possibly significant add-ons to their own funds requirements for market risk. However, Articles 325bf(6) and 325az(9) foresee the possibility that competent authorities may permit an institution, under extraordinary circumstances, to continue using its internal model for the purpose of calculating the own funds requirements for the market risk of a trading desk that does not meet either one or both of those two requirements in that period, or to benefit from a derogation that effectively reduces the capital add-on. Moreover, Article 325az(9) mandates the EBA to develop draft regulatory technical standards to specify the extraordinary circumstances under which, subject to the extraordinary circumstances being confirmed by an opinion issued by the EBA, competent authorities may give the above-mentioned permission.

[6] Currently, in accordance with Article 325az CRR, the PLAT is not a requirement that institutions have to meet. They are only required to report those results. However, for simplicity and consistency with the wording included in Article 325az(9), the draft of the impact assessment already reflects a scenario where institutions are required to meet the PLAT requirements for using the internal model approach.

B. Policy objectives

The Draft Regulatory Technical Standards on extraordinary circumstances for continuing the use of an internal model under Article 325az(9) CRR aim to support the identification of a situation of extraordinary circumstances.

C. Options considered, assessment of the options and preferred options

Section C. presents the main policy options discussed and the decisions made by the EBA during the development of the draft RTS. Advantages and disadvantages, as well as potential costs and benefits from the qualitative perspective of the policy options and the preferred options resulting from this analysis, are provided.

Extraordinary circumstances criteria

As mentioned above, the EBA is mandated to specify elements – indicators and conditions - that would allow the identification of exceptional circumstances. Such indicators and conditions could be derived from the principles established by the BCBS, which state that 'There may, on very rare occasions, be a valid reason why a series of accurate trading desk level models across different banks will produce many back-testing exceptions or inadequately track the P&L produced by the front office pricing model (for instance, during periods of significant cross-border financial market stress affecting several banks or when financial markets are subjected to a major regime shift)'. As such, the EBA leveraged on the BCBS principles and states in the draft RTS that extraordinary circumstances shall be deemed to be in place where the period of 250 business days preceding the observation date comprises a period of significant cross-border financial market stress or a major regime shift which are likely to render the outcome of the tests underpinning the BT or the PLAT inappropriate. Nonetheless, in order to facilitate, more concretely, the assessment of whether such a significant cross-border financial market stress or major regime shift occurred, the EBA considered two options:

Option 1a: Setting in the Draft RTS granular and quantitative criteria that would automatically trigger the recognition of the significant cross-border financial market stress or major regime shift.

Option 1b: Setting in the Draft RTS more general criteria that should be taken into account to recognize the significant cross-border financial market stress or major regime shift.

Granular and quantitative criteria that automatically trigger the recognition of the significant cross-border financial market stress or major regime shift would have the benefit of simplicity; competent authorities, institutions and any other interested party would only have to analyse the development of specified indicators, and would not have to analyse, beforehand, the suitability of existing, or defined new indicators, that enable a deeper tailored analysis. Such an 'automated', or 'quasi-automated approach' based on similar, if not identical, indicators used by competent authorities, would also have the benefit of harmonizing the recognition of significant cross-border financial market stress or major regime shift across the competent authorities of the European Union, and ultimately support the level playing field between institutions everywhere in the EU. For instance, quantitative volatility indicators could be identified, and thresholds set for them in the draft RTS, as a degree of stress that is sufficiently extraordinary to consider softening or waiving the BT or PLAT requirements is, at the very least, associated with high, significantly increased volatility levels.

On the other hand, elements of a crisis leading to financial market stress, or of a regime shift, are unique to every such crisis or regime shift and as such, it is not possible to specify, ex ante, a reliable and exhaustive list of suitable indicators or factors in the RTS, that adequately capture the nature and intensity of potential future financial market stress or regime shift. Establishing a meant-to-be-exhaustive, but, considering real developments, too narrow list of indicators and factors feeding into an automated mechanism may result in the extraordinary circumstances framework being triggered too frequently or prematurely, and may effectively undermine the existing prudential framework.

For these two reasons, it is not advisable to prescribe, which indicators or factors – and their levels – should serve as the basis for identifying a significant cross-border financial market stress or major regime shift. More general, and therefore more flexible, criteria would be more fit for purpose.

As regards the cost of compliance with the provisions of the RTS, it is not expected that institutions would incur significant costs with regard to either option. Competent authorities have to invest a bigger effort to make a tailored analysis in order to recognize – or not – a significant cross-border financial market stress or major regime shift, when the RTS only stipulate more general criteria, compared to applying concrete, predefined granular and quantitative criteria. However, the costs are not deemed to be material in either case and exceeded by the above-mentioned benefits.

On the basis of the above, **the Option 1b has been chosen as the preferred option** and the Draft RTS will set more general criteria that should be taken into account to recognize the significant cross-border financial market stress or major regime shift.

D. Conclusion

The Draft Regulatory Technical Standards on extraordinary circumstances for continuing the use of an internal model under Article 325az(9) CRR will support the identification of a situation of extraordinary circumstances. It sets a framework for recognising a period of significant cross-border financial market stress or of a major regime shift, which may qualify as situations of extraordinary circumstances. For the institutions, the draft RTS is not expected to trigger costs. For the competent authorities, the benefit of having the leeway to take into consideration indicators and factors that truly reflect the nature of the extraordinary circumstances – would exceed the costs of the implementation of the process of recognition of extraordinary circumstances based on the more general criteria. On a more general point of view, main benefit of the draft RTS will be to establish a framework for triggering specific derogations from applying the provisions for the calculation of own funds requirements for market risk in circumstances were this is deemed warranted. Overall, the impact assessment on the draft RTS suggests that the expected benefits are higher than the incurred expected costs.

4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for 3 months and ended on 3 November 2023. 1 response was received, which was published on the EBA website.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In some cases, the same respondent repeated its comments in the response to different questions. In such cases, the comments, and EBA analysis are included in the section of this paper where EBA considers them most appropriate.

Changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
Definition of extraordinary circumstances	1. Recital 1 of the RTS states that 'In line with the principle stipulated by the BCBS, extraordinary circumstances should therefore be recognised only, where there is a situation of significant cross-border financial market stress, or a major regime shift, that affects institutions all across the EU or EEA'. However, the BCBS standard mentions the significant cross-border financial market stress or major regime shift as possible examples of extraordinary circumstances, rather than the only circumstances that justify the derogation from compliance (MAR 32.45: 'for instance, during periods of significant cross-border financial market stress affecting several banks or when financial markets are subjected to a major regime shift'). Thus, we believe that the approach of the EBA RTS is stricter than that established by the BCBS Standards for the reasons described below. 2. Although we understand that a frequent grant of these permissions would undermine the substance of the regulatory framework, we believe there are other extraordinary circumstances not mentioned in the RTS that could justify the application of such permissions, such as local or regional economic or financial crises or deeper than expected cyclical downturns. Thus, we believe that the RTS wording should be modified to address potential disrupting and systemic causes beyond the two extreme cases foreseen in the draft RTS. This recital is very prescriptive, and we recommend that it should be revised to allow for other circumstances that temporarily can affect the PLAT and back-testing (BT) requirements to be addressed as and if required,	The purpose of the RTS is to define the term extraordinary circumstances and operationalise the 'extraordinary circumstances'-framework. For that purpose, the RTS have to strike a balance between setting a clear framework and boundary on one hand and allowing for sufficient flexibility to respond to ex-ante unknown situations on the other hand. The content of the RTS has to go beyond the high-level principles stipulated in the BCBS' framework by setting out the minimum scope and starting point for the assessment of whether observable circumstances could qualify as 'extraordinary' or not. The EBA believes that the threshold for triggering the 'extraordinary circumstances'-framework should be rather high, among other because its purpose is not to address the situation of individual institutions. Institutions are expected to prepare for adverse events as part of their normal business operations. In particular, local economic or financial crises and deeper than expected cyclical downturns are deemed to be part of the normal business operations, in general not warranting a temporary adjustment of the regulatory framework. There is, on one hand, the identification of extraordinary circumstances, based mainly on an assessment of markets, and on the other hand the decision on the consequences of those extraordinary circumstances for the institutions/group in question, i.e. the decision which	Minor revisions of recital

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	while bearing in mind the overall principle that the circumstances need to be exceptional. These systemic or extreme events or situations must be assessed on an individual basis by the supervisor, not only at the group-wide level but at entity level, to determine if the features and spirit of those events align with the BCBS Standards. 3. There are specific cases where banks due to their different subsidiary-branch structures may have different booking and risk management models for position netting or offsetting. In these cases, the applicability of the extraordinary circumstances framework will be limited, as it applies only to situations impacting the EU or EEA. This can have negative impact at trading desk performance for banks with material exposure to other geographies and markets, as different conditions and crises may apply. For EU-based banks that have trading desks located and trading in out-of-EU/EEA geographies, the use of IMA requires application to the competent authorities on a consolidated basis, despite operating out-of-EU jurisdictions. This limitation in the proposed scope of the exceptional circumstance provision impacting EU or EEA institutions would exclude situations impacting subsidiaries in 3rd countries. As per question 2 of the consultation, VIX index, which is a volatility indicator for US markets, is allowed to be used to identify situations of significant cross-border financial market stress or of a major regime shift. Similarly, we believe that more flexibility is required in the wording of the RTS that when recital 1 mentions 'that affects institutions all across the EU or EEA', it covers those institutions whose trading desks also participate in the market (or product) where the extraordinary circumstances are taking place, whether	overshootings can be disregarded because of those extraordinary circumstances, or which trading desks the AIMA can be applied to despite them failing the back-testing and/or PLAT requirements. The RTS only focus on the former assessment; the latter decision on the consequences, to be taken by the competent authorities, will focus on the entities (of the group) having obtained the permission to apply an internal model. As the mandate for the RTS originates from EU legislation, the assessment of whether extraordinary circumstances should be declared will inevitably focus on the impact of the crisis or regime shift or financial market stress on entities located in the EU. As such, crises or stress occurring in other geographical areas, without spill-over effects on European financial market, will likely not be deemed sufficient to trigger the extraordinary circumstances-framework at EU level, even if some European-headed institutions operating in that geographical area are affected (i.e. while the affected entities might benefit from the extraordinary circumstances framework established and triggered in that jurisdiction for their subsidiaries in that area and compliance with the own funds requirements at the level of those subsidiaries, there would be no derogations from the existing regulatory framework for the application of the EU regulatory framework at consolidated level). In contrast, when the extraordinary circumstances-framework is triggered at the level of the EU, the application of the framework at consolidated level may also benefit subsidiaries outside the EU (and EEA).	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	these are based on the EU/EEA or not, and that it is not interpreted as such circumstances affecting the EU in general. 4. Therefore, we propose that recital 1 (and pertinent articles of the RTS related to these comments) should be amended as follows: a) the wording of 'financial market stress or regime shift' should be replaced by a generic reference to a systemic or extreme financial, political, or economic event that caused such turmoil. b) the wording at the end of the first paragraph 'that affects institutions all across the EU or EEA' should be modified to align with the wording in the BCBS Standards (MAR 32.45): 'that affects accurate trading desk level-models across different banks'. We propose the final redaction to be: 'In line with the principle stipulated by the BCBS, extraordinary circumstances should therefore be recognised ~~only, such~~ where there is a situation of significant ~~cross-border~~ financial market stress, or a major regime shift, that would affect ~~institutions all across~~ the model's ability to pass PLAT and BT at trading desk level, across different banks ~~the EU or EEA~~ irrespective of trading desks' location. In these cases, the supervisory authorities should adopt a case-by-case assessment.'	'Systemic or extreme financial, political, or economic events' may also include events that do not actually, or only mildly, affect financial markets. For that reason, the RTS remain unchanged by focusing on the resulting circumstances (financial market stress, major regime shift [in financial markets]) rather than a trigger event.	

Responses to questions in Consultation Paper EBA/CP/2023/19

Question 1.
Besides volatility indices like, for example, the VIX and VSTOXX, are there any other factors or indicators, in your view, that could be used to identify situations of significant cross-border financial market stress or of a major regime shift?

Volatility, correlation,	We believe that volatility indices such as the VIX in the US and the VSTOXX in Europe are natural indicators than can be used to identify situations of significant cross-border financial market stress or of a major regime shift. They could be naturally supported by	The EBA's takes note of the respondent's support for volatility indicators as relevant indicators for identifying cross-border financial market stress and major regime shifts. The RTS itself stops at referring to volatility	Addition of correlation indicators to the presumptive list

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
liquidity, and other indicators	other market implied volatility indices in Asia or linked to non-equity asset classes (e.g. market implied volatility indices for rates) or realised volatility indicators (although those indicators will identify these stress situations with some delay, by construct of the indicators that are computed as averages based on historical measure); measures are important indicators. However, often there are symptoms of extraordinary circumstances that are more properly captured in metrics other than volatility measures. Below we outline indicators that should also be considered. **1. Correlation indicators are very important.** Indeed, stress periods are characterised by markets dislocations, which are characterized by increased correlations and heightened systemic risk. In principle, higher implied correlations can be assessed for instance from the increase of index implied volatilities over individual constituents average implied volatilities. Alternatively, implied (credit) correlations could be assessed from the relative price of cash securitisation tranches, with equity or mezzanine tranche prices decreasing relative to the price of senior tranches; **2. Liquidity indicators** (e.g. jump of risk-free rates (RFRs)/overnight indexed swap (OIS) indicators) to identify a major regime shift associated with a level of stress similar to a situation of significant cross border financial market stress (e.g. a liquidity crisis); **3. Unusual deviations in the markets:** i. Unusual spread deviations between safer and riskier assets. For example, a sharp widening of spreads between developed and emerging markets caused by a sudden flight to quality triggered by a country-specific or regional debt crisis.	indicators in a general manner. The concrete indicators to be analysed – including indicators focused on certain geographical areas, or asset classes – would be chosen based on the concrete circumstances to be assessed. In the light of the comments received, correlation indicators were added to the list of (the minimum set of) factors and indicators which will be taken into consideration for the identification of extraordinary circumstances (in every case). As regards the other indicators and factors proposed, the EBA decided not to include them in the list of factors and indicators that would always and systematically be assessed, as they are insufficiently concrete (e.g. unusual deviations in the markets – which spread would be relevant, and which deviation is 'unusual'?), may just constitute a factor of lesser importance (e.g. trading restrictions) or are deemed to be unreliable (e.g. unusual number of back-testing overshootings across institutions). Even if they are not included in the presumptive list of the RTS, these factors and indicators can still be considered in the assessment of concrete cases, if they are deemed suitable to reflect the nature of the events and circumstances.	of factors and indicators to be assessed in every case

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	ii. Unusual deviations between cash and derivatives markets. For example, credit spreads on bonds and CDS for same or similar reference entities may experience an unusual divergence (a symptom would be for example a sudden large deviation between the iBoxx EUR High Yield indices and the ITRAXX crossover index spreads). Another example would be large differences between spot and futures/forward prices. **4. Restrictions on trading or delivery of financial instruments or commodities.** For example, restrictions on convertibility of a certain currency. In other example, the restrictions faced by the Russian rouble during the Russia-Ukraine war. Another example occurred during the COVID crisis on the ability to move gold across markets that triggered unusual differences of spot/futures prices across markets. 5. In addition, an unusual number of back-testing overshootings in a short period of time (e.g., more than 2 overshootings in a monthly period) being notified by several banks as well as the volume of contracts referencing those indicators and / or their sudden moves could also naturally complete the indicators themselves. Every crisis is unique and cannot be defined ex ante. Thus, we believe that the list of indicators should not be fixed nor exhaustive as they will naturally evolve through time.		
Question 2. Do you agree with the approach presented in the RTS? If not, please clarify which alternative approach could be used or which additional aspects should be taken into consideration.			
Definition of indicators, absolute levels	We appreciate that Option 1b has been chosen as the preferred option and the Draft RTS will set more general criteria that should be taken into account to recognize the significant financial market	It is the EBA's view and understanding that a significant increase in volatility levels would be a necessary, albeit not sufficient, condition for circumstances to be declared	Revision of the presumptive list of indicators and

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of volatility as reference point	stress or major regime shift. Nevertheless, the EBA RTS mentions precise indicators and factors that reflect the nature of the financial stress or regime shift whereas none of them are listed in the Basel text (MAR 32.45). The industry recommends: 1. At the very least, to remove (b) of paragraph 2 of Article 1 as there should not be reference to absolute volatility levels observed during the global financial crisis or the COVID-2019 pandemic. Also, we note that a sudden jump of volatility after a long period of low volatility may reference a period of financial stress or regime shift (the level of which being in relative terms high compared to the low-level volatility but not necessary as high in absolute terms compared to the reference of the global financial crisis or the COVID-2019 pandemic); 2. Ideally, we recommend removing the whole paragraph 2 of Article 1 to align with the Basel principle.	‘extraordinary’. However, a reference to a ‘significant’ increase was deemed too vague for the purposes of the RTS, and therefore framed with reference to the two major crises and events where, in retrospect, the ‘extraordinary circumstances’-framework would likely have been triggered, had it already existed at the time of those crises and events. Nevertheless, in response to the comments received during the public consultation, relative changes in volatility levels as observed during the Great Financial Crisis or the COVID-19 pandemic have been included as an additional reference point for the assessment.	factors to be assessed to also include relative changes in volatility levels
Reference population for determining extraordinary circumstances	Besides, we understand that extraordinary circumstances are meant to address situations of systemic stress, i.e. expected to have an impact on several types of portfolios and several types of banks (whether using an internal model or not), and for those banks using internal models, this should not be dependent on the model used. This overarching principle should be more clearly addressed in the final RTS. Therefore, it should be clarified that what matters is the number of banks affected if they were using an internal model on typical portfolios rather than the number of affected banks. This clarification is important to be made, given the limited number of banks expected to have a validated internal model.	The conditions stipulated in the RTS are twofold: There must be cross-border financial market stress or a regime shift, and that stress or regime shift must render the outcome of the PLAT or back-testing inappropriate. The first condition would be assessed at a general (market) level, considering any entity in the EU, irrespective of the approach used for calculating own funds requirements for market risk, i.e. the condition is to be understood as systemic stress/regime shifts having to impact a larger set of portfolios and different types of banks (i.e. markets in general). The second condition would be assessed with a focus on the entities in the EU that actually have the permission to use a model.	None

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Question 3. What kind of regime shifts would you expect to render the outcome of the back-testing/PLAT inappropriate?			
Delayed recognition of changing circumstances in VaR compared to P&L	1. A value at risk (VaR) measurement is likely to capture an extreme market shift with a time lag, as VaR is calibrated using 1y of the most recent historical data and would need some days to adjust to the new market conditions (i.e., there would need to be 2-3 extreme market observations for the shift to be incorporated in the 1% confidence interval metric). This time lag may lead to BT overshootings as, in contrast to VaR, the hypothetical and actual P&Ls capture an extreme market shift immediately.	The EBA takes note. This consideration is the motivation behind the requirement to assess how quickly the financial market stress or regime shift manifested.	None
PLAT failure in periods of low volatility	2. PLAT failures could occur in periods of low volatility, mainly due to the Spearman correlation (as correlation assessment between the RTP&L and the HP&L is generally blurred in a situation of continuous low level of volatility).	The EBA takes note.	None
Question 4. How do you expect the PLAT results to be affected or to deteriorate during a period of financial stress or a regime shift, and what are the reasons for your expectation?			
Manifestation of risks not in the model	1. On PLAT, although this is more difficult to assess, during a financial stress period or a regime shift, the impact from some risks which are not in the model and are usually small can become much bigger and hence affect the PLAT. Therefore, more desks failing the PLAT can be expected during such periods;	The EBA takes note. No additional provision was added to the RTS, as the criterion is relatively vague and the magnitude of risks not in the model cannot be assessed in a relatively straightforward manner across institutions.	None
PLAT and back-testing failures	2. As a side note, the US NPR3 provides a possibility to exempt events due to technical issues unrelated to the internal model (in the context of BT requirements at desk level). This flexibility is crucial in the European Regulation too, as resources tend to focus	The EBA takes note. This point cannot be reflected in the RTS, as it is not related to the identification of the extraordinary circumstances themselves. However, within the limits set by the CRR (which does not explicitly	None

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due to technical issues	on other priorities (rather than remediating technical production issues) in period of financial stress, as it was the case during the COVID-19 pandemic. Hence, during such stressed periods, technical issues leading to BT overshootings shall not be treated as related to some flaws in the model but rather as a consequence of the extraordinary circumstances and hence discarded. Similarly, failing the PLAT as a result of technical issues during extraordinary circumstances should be disregarded as a consequence of the situation rather than a model deficiency.	foresee an exclusion of overshooting for technical reasons, but does not forbid this consideration either) and once extraordinary circumstances have been acknowledged (under the CRR3, by means of an opinion issued by the EBA), the competent authority may consider this aspect in its (institution-specific) assessment of which back-testing overshootings a specific institution can disregard.	