

EBA/CP/2015/09

11 May 2015

Consultation Paper

Draft Regulatory Technical Standards on Assigning Risk Weights to Specialised Lending Exposures under Article 153(9) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by **11.08.2015**. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD)¹ set out prudential requirements for banks and other financial institutions which have been applied from 1 January 2014. Among others, the CRR contains specific mandates for the EBA to develop draft Regulatory Technical Standards (RTS) to specify how institutions shall take into account the following factors in assigning risk weights to specialised lending exposures: “financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public private partnership income stream, and security package”. This consultation paper sets out the EBA proposal to fulfil this mandate.

Main features of the Consultation Paper for the draft RTS

Specialised lending exposures are a specific type of exposure, where the exposure is to an entity which was created specifically to finance or operate physical assets or is an economically comparable exposure, the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate and the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise. Within the Internal Ratings Based (IRB) approach, the CRR allows for a special treatment of specialised lending exposures, in the case the institution is not able to estimate the PDs or the institution’s PD estimates do not meet the requirements of Probability of Default (PD) estimation. For these types of exposures, the CRR puts forward a set of supervisory risk weights, which have to be assigned on the basis of a classification in five categories, depending on the underlying credit risk, as well as the remaining maturity. This approach is also known as supervisory slotting criteria approach for specialised lending exposures in the Basel framework.

These proposed draft RTS use the Basel framework as a baseline given that it has been adopted nationally in a number of EU Member States, although taking into account the European experiences. These proposed draft RTS define four classes of specialised lending: project finance, real estate, object finance or commodities finance. Within each class these proposed draft RTS specify how the factors, i.e. “financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public private partnership income stream, and security package” are to be taken into account. In addition, these

¹ Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

proposed draft RTS specify how the above mentioned factors should be combined in order to determine the final assignment to a category.

Finally, in order to tailor the reported information to the specific supervisory treatment of specialised lending exposure, these proposed draft RTS propose specific documentation requirements.

3. Background and introduction

1. The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD)² set out prudential requirements for banks and other financial institutions which have been applied from 1 January 2014. Among others, the CRR contains specific mandates for the EBA to develop draft Regulatory Technical Standards (RTS) to specify how institutions shall take into account the following factors in assigning risk weights to specialised lending exposures: “financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public private partnership income stream, and security package”.

Background of the proposed draft RTS

2. Specialised lending exposures are a special type of exposure within the corporate exposure class in the Internal Models Based (IRB) approach. The CRR defines specialised lending exposures in Article 147(8) CRR as follows:
 - (a) the exposure is to an entity which was created specifically to finance or operate physical assets or is an economically comparable exposure;
 - (b) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate;
 - (c) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.
3. Article 153(5) CRR says “For specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet the requirements set out in Section 6³, the institution shall assign risk weights to these exposures according to Table 1, as follows:

² Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

³ On the requirements for the IRB approach

Remaining Maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2.5 years	50%	70%	115%	250%	0%
Equal or more than 2.5 years	70%	90%	115%	250%	0%

4. In assigning risk weights to specialised lending exposures institutions shall take into account the following factors: “financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public private partnership income stream, and security package”.
5. EBA has the mandate (stemming from Article 153(9) CRR) to develop the RTS to specify how institutions shall take into account these factors in assigning risk weights to specialised lending exposures for which an institution is not able to estimate PDs or the institutions' PD estimates do not meet the requirements.
6. The current Basel text (Annex 6) contains detailed criteria for assessing the credit risk of different types of specialised lending, which are referred to as the slotting criteria. Given the well-established use of these criteria, these proposed draft RTS are drafted on the basis of this international guidance.
7. The Basel text includes five sub-classes of specialised lending: project finance, object finance, commodities finance, income-producing real estate, and high-volatility commercial real estate. However, Annex 6 of the Basel text only contains 4 tables with supervisory slotting criteria for specialised lending: (1) project finance, (2) income-producing real estate and high-volatility commercial real estate, (3) object finance and (4) commodities finance. As such, Basel does not differentiate the slotting criteria for income-producing real estate and high-volatility commercial real estate. Given that the CRR does not include specific requirements which differentiate between income-producing real estate and high-volatility commercial real estate, these proposed draft RTS differentiate between the four mentioned classes and include separate assessment criteria in order to take into account the factors of financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer and security package. This approach ensures that the assessment criteria are tailored to the nature and specificities of the different specialised lending exposure.
8. These proposed draft RTS specify how the above mentioned factors, as well as the sub-factors which lay down further specifications of these factors, should be assessed, as well as how institutions should combine these factors in order to determine the final assignment to a category. These proposed draft RTS provide two alternative rules for the combination of the

factors to the final assignment to a category. The first option suggests that final assignment to a category should be maximum one step lower than the cardinal number of the highest category of all factors the specialised lending exposure has been assigned to. The second option requires institutions to define the weight for each factor, and the final assignment to a category depends on the weighted average of the cardinal numbers of the categories the factors have been assigned to, where the institution may round the number up or down to obtain the cardinal number in case the weighted average is a decimal number. As part of this consultation paper, EBA is therefore seeking input from stakeholders on the advantages, disadvantages and feasibility of either approach. Under both options, institutions should ensure consistency in the way the different factors are combined, by developing internal guidelines or benchmarks.

9. For the purpose of assigning a specialised lending exposure to a category ranging from 1 to 5, institutions should first verify whether a specialised lending exposure is considered in default in accordance with the conditions set out in Article 178 CRR. When a specialised lending exposure is considered to be in default, institutions shall assign that exposure to category 5. When a specialised lending exposure is considered not to be in default, institutions should assign that exposure to category 1, 2, 3 or 4 by taking into account the assessment criteria which are laid down in Annexes 1 to 4.
10. Finally, in order to tailor the reported information to the specific supervisory treatment of specialised lending exposure, these proposed draft RTS set out specific documentation requirements.

Advantages and disadvantages of the slotting approach

11. The slotting approach used for specialised lending exposures is a part of the IRB framework in the CRR. The use of this approach is motivated by the fact, that for these exposures it is not always possible to estimate PD (and/or LGD) or the PD estimates do not meet the requirements of the CRR. The slotting approach however allows a risk sensitive way of determining capital requirements, consistent with the risk profile of the relevant specialised lending exposures, which allows an ordinal ranking of the risk of these exposures.
12. The EBA is currently in the process of reviewing the overall IRB framework, as illustrated in a recent discussion paper on the future of the IRB approach⁴. The slotting approach has however received limited attention in this regard, due to its application to only around a fourth of all specialised lending exposures under the IRB approach⁵. The EBA has therefore not collected information about the potential variability of the slotting approach, but as part

⁴ See <http://www.eba.europa.eu/regulation-and-policy/credit-risk/discussion-paper-on-the-future-of-the-irb-approach>.

⁵ See table 3 in section 5 of this consultation paper.

of this consultation paper, the EBA is also seeking the input from stakeholders on the use of the slotting approach in general. The EBA would in particular be interested in the views as regards the operational challenges of using the slotting approach, just as well as views on whether the slotting approach could have broader use beyond specialised lending exposures, for instance as an alternative for other exposures, which are currently modelled under the IRB framework.

Explanatory text for consultation purposes:

Question 1: What are the operational challenges of using the slotting approach? Is it possible to obtain comparable capital requirements across institutions using the slotting approach? Should the slotting approach in your view be extended to other types of exposures, and if yes, for which types of exposures would this be particularly useful?

4. Draft RTS on Assigning Risk Weights to Specialised Lending Exposures

COMMISSION DELEGATED REGULATION (EU) No .../.. of XXX

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assigning risk weights to specialised lending exposures

(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 investment firms and amending Regulation (EU) No 648/2012⁶, and in particular the third subparagraph of Article 153 (9) thereof,

Whereas:

- (1) In accordance with Article 153(5) of Regulation (EU) No 575/2013, institutions are required, for the purpose of assigning risk weights to a specialised lending exposure, to assess the remaining maturity of the exposure and assign the exposure to a category ranging from 1 to 5 as referred to in Table 1 of the first subparagraph of that Article. As a result, for the purpose of taking into account the factors referred to in the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013 when assigning risk weights to specialised lending exposures, institutions should essentially assign the specialised lending exposure to one of the categories of Table 1 referred to in the first subparagraph of that Article based on their assessment of each specialised lending exposure against each of these factors. In order to ensure a harmonised approach with regard to the assignment of specialised lending exposures to categories, it is appropriate to specify how factors should be taken into account by linking the relevant factors directly to the corresponding categories of that Table.

⁶ OJ L 176, 27.06.2013, p. 1.

- (2) Further, in order to adequately take into account each of the factors of financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, and security package when assigning risk weights to specialised lending exposures, it is appropriate to further specify these factors in the form of sub-factors which provide further clarification about the nature of those factors.
- (3) In order to take into account the specificities of different classes of specialised lending exposures, according to their purpose and the origin of the income generated by the assets, in accordance with Article 147(8) of Regulation (EU) No 575/2013, it is appropriate to provide different assessment criteria for the factors referred to in the second subparagraph of Article 153(5) of that Regulation. Accordingly, institutions should assign any of the specialised lending exposures subject to the treatment of Article 153(5) of Regulation (EU) No 575/2013 to that class which most closely corresponds to the description of one of those classes. This is also consistent with the internationally-agreed standards on assigning risk weights to specialised lending exposures, as specified by the Basel Committee on Banking Supervision in the Basel II framework.
- (4) Given that the remaining maturity of a specialised lending exposure is crucial in the determination of the appropriate risk weights for specialised lending exposures, and given that the remaining maturity of such exposures is not merely established in the contractual provisions, but might be altered subsequently, the determination of the length of the remaining maturity of the exposure as either 'less than 2.5 years' or 'equal or more than 2.5 years' as provided in Table 1 of Article 153(5) of Regulation (EU) No 575/2013, should be based on the higher of the contractual remaining maturity and the expected remaining maturity of the exposure.
- (5) For the purpose of taking into account the factors referred to in the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013 when assigning a specialised lending exposure to a category ranging from 1 to 5 as referred to in Table 1 in the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013 and where institutions assess that the exposure is in default in accordance with the conditions set out in Article 178 of Regulation (EU) No 575/2013, institutions should assign such an exposure to category 5 of that table. This is consistent with the higher EL values for specialised lending exposures assigned to category 5 as referred to in Table 2 of Article 158(6) of Regulation (EU) No 575/2013 and is consistent with the approach taken in the relevant internationally-agreed standards.

[Option 1:]

(6) *In order to achieve consistency in the assignment of specialised lending exposures to categories and in line with the requirement of consistency in the assignment to grades or pools, referred to in point (a) of Article 171(1) of Regulation (EU) No 575/2013, institutions should specify for each type of exposure how the different factors are combined in the final assignment of the specialised lending exposure according to one of the categories of Table 1 of the first subparagraph of Article 153(5) of that Regulation. In order to ensure that institutions assign risk weights to specialised lending exposures in a sufficiently prudent way, the final assignment to a category should be, at most, one cardinal number lower than the highest category of all factors the specialised lending exposure has been assigned to.*

[Option 2:]

(6) In order to achieve consistency in the assignment of specialised lending exposures to categories and in line with the requirement of consistency in the assignment to grades or pools, referred to in point (a) of Article 171(1) of Regulation (EU) No 575/2013, institutions should specify for each type of exposure how the different factors are combined in the final assignment of the specialised lending exposure to one of the categories of Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013. In order to ensure that institutions assign risk weights to specialised lending exposures in a sufficiently prudent way, institutions should specify the weight that they assign to each factor, where that weight should not be lower than [10%]. The final assignment to a category should be done on the basis of the weighted average of the cardinal numbers of the categories to which the exposure has been assigned to for each factor.

Explanatory text for consultation purposes:

With regard to the specification of the combination of the different factors for the final assignment to a category, this Consultation Paper proposes two options, which are specified in Article 1(3). The above recitals accompany these options. Further clarification to these options can be found in the explanatory text below Article 1(3).

(7) Given that specialised lending exposures subject to the treatment referred to in Article 153(5) of Regulation (EU) No 575/2013 belong to the corporate exposure class within the IRB approach, all requirements of the IRB approach mentioned in Regulation (EU) No 575/2013 apply, to the extent relevant and in accordance with the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013, also to these specialised lending exposures. This includes, amongst others, the requirements for assigning

exposures to grades or pools in accordance with Article 171 of that Regulation, and in particular the requirements for applying conservatism where institutions have less information on certain factors or sub-factors in accordance with Article 171(2) of that Regulation. Similarly, the provisions regarding the possibility of human judgement overriding the final assignment of a specialised lending exposure to one of the categories of Table 1 of the first subparagraph of Article 153(5) of that Regulation also apply in accordance with Article 172(3) of that Regulation and as well as the technical standards referred to in Articles 144(2), 173(3) and 180(3)(b) of that Regulation. Further, the application of the rules for assigning specialised lending exposures to the relevant categories should be based on the relevant rules for each type of exposures within the meaning of Article 142(1)(2) of Regulation (EU) No 575/2013.

- (8) In order to ensure the possibility to review the adequate application of the rules regarding the specificities of specialised lending exposures, institutions should be required to sufficiently document their decisions regarding how to take into account the factors referred to in the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013. In that context, it is appropriate that they should be required to document several of the elements of that process for each specialised lending exposure for which risk weights are assigned according to this Regulation.
- (9) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (10) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) 1093/2010⁷,

HAS ADOPTED THIS REGULATION:

⁷ 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).

Article 1

Overview of the process for taking into account the factors affecting the risk weights of specialised lending exposures

1. When assigning risk weights to specialised lending exposures, institutions shall take into account the factors referred to in the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013, in the following manner:
 - (a) for exposures that are in default, in accordance with Article 178 of Regulation (EU) No 575/2013, institutions shall assign these exposures to category 5 of Table 1 referred to in the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013;
 - (b) for all other exposures except those referred to in point (a), institutions shall follow the requirements referred to in paragraphs 2 to 3.
2. For the purposes of paragraph 1(b), institutions shall take into account the factors referred to in the second sub-paragraph of Article 153(5) of Regulation (EU) No 575/2013, in accordance with the following requirements in sequence:
 - (a) they shall determine which assessment criteria among those referred to in Annexes 1 to 4 are applicable to the specialised lending exposure, in accordance with Article 2;
 - (b) they shall assess the specialised lending exposure, with reference to each factor, against the specifications provided based on the sub-factors contained in the relevant Annex;
 - (c) based on the classification of the specialised lending exposure under each of the factors, referred to in point (b), they shall determine the overall category under which to ultimately classify the specialised lending exposure, in accordance with paragraph 3 and 4.
3. For the purposes of paragraph 2(c) institutions shall do all of the following:

[Option 1:]

- (a) *establish which is the highest cardinal number of the categories the specialised lending exposure has been assigned to among all factors;*
- (b) *assign the specialised lending exposure to a category that is at most one level lower than the highest cardinal number of the categories referred to in point (a).*

[Option 2:]

- (a) *specify the weight in percentage that they assign to each factor, under the condition that such a weight is not lower than [10%];*

- (b) *determine the weighted average of the categories under which they have classified the specialised lending exposure for all factors;*
- (c) *where the weighted average is a decimal number, institutions shall round this number up or down in order to determine the category to which they shall assign the exposure.*
4. Institutions may override the final assignment of a specialised lending exposure to one of the categories of Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013 in accordance with Article 172(3) of that Regulation and as well as the technical standards referred to in Articles 144(2), 173(3) and 180(3)(b) of that Regulation.
5. In the cases where the specifications provided for one or several of the sub-factors contained in the relevant Annex are equal across several categories for that sub-factor, institutions shall assign the relevant factor to a category based on the classification of the specialised lending exposure of the other non-overlapping sub-factors and make appropriate and conservative adjustments to that assignment, if the assignment of the overlapping sub-factors is to a higher cardinal number of the categories referred to in Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013.

Explanatory text for consultation purposes:

With regard to the specification of the combination of the different factors for the final assignment to a category, this Consultation Paper proposes two options, which are specified in Article 1(3).

In the first option, a relatively straightforward rule is proposed, whereby the final assignment to a category can only be at most one step lower than the cardinal number of the highest category of all factors. If for example the institutions assigns category 1 to four of the factors and category 4 to the other factor, this rule will imply that the final assignment cannot be better than category 3. The advantage of this rule is its simplicity, as well as the possibility to accommodate for special circumstances, and it would allow a prudent assessment of the underlying credit risk for all specialised lending exposures subject to the approach in Article 153(5) of Regulation (EU) No 575/2013. One potential disadvantage of this option is that the final assignment of an exposure may only be determined by one or a few factors, meaning that not all factors determine the final assignment.

In the second option, the institutions are required to specify the weight that it assigns to each factor in order to determine the final assignment to a category. This option requires that the institution determines the final assignment to a category on the basis of the weighted average of the cardinal numbers of the categories all factors have been assigned to, where a minimum weight of [10%] should be applied to each factor. The institution may then round this number up

or down in order to determine the final assignment of the exposure to a category. The practical implementation of this option is potentially less straightforward than the first option, but it has the advantage of being clear and transparent. Furthermore, this option rules out that institutions would discard one or several factors in the assignment to a category. EBA would like to consult the industry and other stakeholders on the feasibility of specifying weights to the factors and putting a [10%] floor to this weight. It should be noticed that overrides would be allowed to the final assignment of the exposure to a category under both option 1 and option 2, in certain circumstances, in line with Article 172(3) CRR and with the specifications in the CP for the draft RTS on assessment methodology for IRB approach, but these overrides should be documented, and the performance of these exposures should be analysed.

The following example should clarify option 2. An institution assigns the first factor to category 2 with a weight of 15%, the second factor to category 1 with a 10% weight, the third factor to category 1 with a 15% weight, the fourth factor to category 3 with a 25% weight and the fifth factor to category 2 with a 35% weight. The weighted average of the categories to which the factors are classified is 2, because $2*0.15 + 1*0.10 + 1*0.15 + 3*0.25 + 2*0.35 = 2$. The specialised lending exposure should therefore be assigned to category 2.

Question 2: What would be the preferred approach for the combination of the factors into a final assignment to a category? What are the advantages and drawbacks of either approach? What would be the impact of both options on capital requirements? Are both options equally clear or should further guidance be provided? Are there other approaches that could be used to harmonise how the different factors are combined into a final assignment for the risk weight?

Article 2

Applicable assessment criteria for different classes of specialised lending exposures

1. For the purposes of point (a) of Article 1(2), all of the following shall apply:
 - (a) for specialised lending exposures that qualify as project finance in accordance with paragraph 2(a), institutions shall apply the assessment criteria referred to in Annex 1;
 - (b) for specialised lending exposures that qualify as real estate in accordance with paragraph 2(b), institutions shall apply the assessment criteria referred to in Annex 2;
 - (c) for specialised lending exposures that qualify as object finance in accordance with paragraph 2(c), institutions shall apply the assessment criteria referred to in Annex 3;
 - (d) for specialised lending exposures that qualify as commodities finance in accordance with paragraph 2(d), institutions shall apply the assessment criteria referred to in Annex 4.
2. For the purposes of paragraph 1, all of the following shall apply:

- (a) a specialised lending exposure shall qualify as ‘project finance’ where the funding is used for large, complex and expensive installations, including, in particular, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure, so that the income generated by the assets would typically be the money generated by the contracts for the facility’s output, such as the electricity sold by a power plant;
- (b) a specialised lending exposure shall qualify as ‘real estate’ where the funding is used to finance the development or acquisition of real estate, including, in particular, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, hotels, and land, so that the income generated by the real estate would typically be lease or rental payments or the proceeds from the sale of such real estate;
- (c) a specialised lending exposure shall qualify as ‘object finance’ where the funding is used for the acquisition of physical assets, including in particular ships, aircraft, satellites, railcars, and fleets, so that the income generated by the assets would typically be lease or rental payments obtained from one or several third parties;
- (d) a specialised lending exposure shall qualify as ‘commodities finance’ where the funding is used to finance reserves, inventories, or receivables of exchange-traded commodities, including, in particular, crude oil, metals, or crops, so that the income generated by the assets would typically be the proceeds from the sale of the commodity.

Explanatory text for consultation purposes:

Question 3: Do you agree with the classification of specialised lending exposures and the descriptions given?

Article 3
Documentation

Institutions shall document all of the following for each specialised exposure for which risk weights are assigned according to this Regulation:

- (a) the class of specialised lending;
- (b) the final assignment of the exposure to one of the categories of Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013;
- (c) the assessment of the remaining maturity in accordance with Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013;

- (d) the assignment of the exposure according to the factors and sub-factors to one of the categories of Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013;
- (e) the assessment referred to in Article 1(3).

Explanatory text for consultation purposes:

Question 4: Do you agree with these documentation requirements for each specialised lending exposure for which risk weights are assigned according to this Regulation?

Article 4
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

On behalf of the President
[Position]

Annex 1 – Assessment criteria for Project Finance exposures

	Category 1	Category 2	Category 3	Category 4
Financial Strength				
(a) Market conditions	Few competing suppliers or substantial and durable advantage in location, cost, or technology. Demand is strong and growing.	Few competing suppliers or better than average location, cost, or technology but this situation may not last. Demand is strong and stable.	Project has no advantage in location, cost, or technology. Demand is adequate and stable.	Project has worse than average location, cost, or technology. Demand is weak and declining.
(b) Financial ratios (e.g. debt service coverage ratio (DSCR⁸), Interest Coverage Ratio (ICR⁹), loan life coverage ratio (LLCR¹⁰), project life coverage ratio (PLCR¹¹), and debt-to-equity ratio)	Strong financial ratios considering the level of project risk; very robust economic assumptions.	Strong to acceptable financial ratios considering the level of project risk; robust project economic assumptions.	Standard financial ratios considering the level of project risk	Aggressive financial ratios considering the level of project risk.
(c) Stress Analysis	The project can meet its financial obligations under sustained, severely stressed economic or sectoral conditions.	The project can meet its financial obligations under normal stressed economic or sectoral conditions. The project is only likely to default under severe economic conditions.	The project is vulnerable to stresses that are not uncommon through an economic cycle, and may default in a normal downturn.	The project is likely to default unless conditions improve soon.

⁸ The Debt Service Coverage ratio ('DSCR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the principal and the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

⁹ The Interest Coverage Ratio ('ICR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

¹⁰ The Loan Life Coverage Ratio ('LLCR') refers to the ratio of the net present value of the cashflow available for debt service to the outstanding debt balance, and refers to the number of times the cashflow available for debt service which can be generated from the asset can repay the outstanding debt balance over the scheduled life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

¹¹ The Project Life Coverage ratio ('PLCR') refers to the ratio of the net present value of the cashflow available for debt service to the outstanding debt balance, and refers to the number of times the cashflow available for debt service which can be generated from the asset can repay the outstanding debt balance over the scheduled life of the project, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

(d) Financial Structure:				
<ul style="list-style-type: none"> Duration of the credit compared to the duration of the project 	Useful life of the project significantly exceeds tenor of the loan ¹²	Useful life of the project exceeds tenor of the loan	Useful life of the project exceeds tenor of the loan	Useful life of the project may not exceed tenor of the loan
<ul style="list-style-type: none"> Amortisation schedule and refinancing risk 	Amortising debt	Amortising debt	Amortising debt repayments with limited bullet payment. Limited refinancing risk.	Bullet repayment or amortising debt repayments with high bullet repayment. High refinancing risk.
(e) Foreign exchange risk (after taking into account hedging)	There is no foreign exchange risk because there is no difference in the currency of the loan and the income of the project.	There is no foreign exchange risk because there is no difference in the currency of the loan and the income of the project.	There is a difference in the currency of the loan and the income of the project, but the foreign exchange risk is considered low because the exchange rate is stable.	There is a difference in the currency of the loan and the income of the project, and the foreign exchange risk is considered high because the exchange rate is volatile.
Political and legal Environment				
(a) Political risk, including transfer risk, considering project type and mitigants	Very low exposure; strong mitigation instruments, if needed	Low exposure; satisfactory mitigation instruments, if needed	Moderate exposure; fair mitigation instruments	High exposure; no or weak mitigation instruments
(b) Force majeure risk (war, civil unrest, etc),	Low exposure	Acceptable exposure	Standard protection	Significant risks, not fully mitigated
(c) Government support and project's importance for the country over the long term	Project of strategic importance for the country (preferably export-oriented). Strong support from Government	Project considered important for the country. Good level of support from Government	Project may not be strategic but brings unquestionable benefits for the country. Support from Government may not be explicit	Project not key to the country. No or weak support from Government
(d) Stability of legal and regulatory environment (risk of change in law)	Favourable and stable regulatory environment over the long term	Favourable and stable regulatory environment over the medium term	Regulatory changes can be predicted with a fair level of certainty	Current or future regulatory issues may affect the project
(e) Acquisition of all necessary supports and approvals for such relief from local content laws	Strong	Satisfactory	Fair	Weak

¹² The tenor of a loan refers to the amount of time left for the repayment of a loan.

(f) Enforceability of contracts, collateral and security	Contracts, collateral and security are enforceable	Contracts, collateral and security are enforceable	Contracts, collateral and security are considered enforceable even if certain non-key issues may exist	There are unresolved key issues in respect if actual enforcement of contracts, collateral and security
Transaction Characteristics				
(a) Design and technology risk	Fully proven technology and design	Fully proven technology and design	Proven technology and design — start-up issues are mitigated by a strong completion package	Unproven technology and design; technology issues exist and/or complex design.
(b) Construction Risk <ul style="list-style-type: none"> • Permitting and siting • Type of construction contract • Likelihood to finish the project at the agreed time and cost 	All permits have been obtained Fixed-price date-certain turnkey construction EPC ¹³ (engineering and procurement contract) It is almost certain that the project will be finished within the agreed time horizon and at the agreed cost.	Some permits are still outstanding but their receipt is considered very likely Fixed-price date-certain turnkey construction EPC It is very likely that the project will be finished within the agreed time horizon and at the agreed cost.	Some permits are still outstanding but the permitting process is well defined and they are considered routine. Fixed-price date-certain turnkey construction contract with one or several contractors It is uncertain whether the project will be finished within the agreed time horizon and at the agreed cost.	Key permits still need to be obtained and are not considered routine. Significant conditions may be attached. No or partial fixed-price turnkey contract and/or interfacing issues with multiple contractors There are indications that the project will not be finished within the agreed time horizon and at the agreed cost.
(c) Completion guarantees ¹⁴ or liquidated damages ¹⁵	Substantial liquidated damages supported by financial substance	Significant liquidated damages supported by financial substance	Adequate liquidated damages supported by financial substance and/or completion	Inadequate liquidated damages or not supported by financial

¹³ An Engineering and Procurement Contract ('EPC') or 'turnkey contract' refers to an agreement between the engineering and procurement contractor ('EPC contractor') and the developer, whereby the EPC contractor agrees to develop the detailed engineering design of the project, procure all the equipment and materials necessary, construct and deliver a functioning facility or asset to the developer, usually within an agreed time and budget.

¹⁴ A completion guarantee refers to a guarantee provided by the contractor to the project's lenders to undertake to deliver the project within the specified timeframe, and to pay for the cost overruns, if any.

¹⁵ A liquidated damage refers to a monetary compensation for a loss, detriment or injury to a person's rights or property, awarded by a court judgment or by a contract stipulation regarding breach of contract.

	and/or strong completion guarantee from sponsors with excellent financial standing	and/or completion guarantee from sponsors with good financial standing	guarantee from sponsors with good financial standing	substance or weak completion guarantees
Track record and financial strength of contractor in constructing similar projects.	Strong	Good	Satisfactory	Weak
<p>(d) Operating risk</p> <ul style="list-style-type: none"> • Scope and nature of operations and maintenance (O & M) contracts • Operator’s expertise, track record, and financial strength • Inherent complexity of O&M activities 	<p>Strong long-term O&M contract¹⁶, preferably with contractual performance incentives¹⁷, and/or O&M reserve accounts¹⁸</p> <p>Very strong, or committed technical assistance of the sponsors</p> <p>The O&M activities are straightforward and transparent. An O&M contract is not strictly necessary to perform the required maintenance.</p>	<p>Long-term O&M contract, and/or O&M reserve accounts</p> <p>Strong</p> <p>The O&M activities are relatively straightforward and transparent.</p>	<p>Limited O&M contract or O&M reserve account</p> <p>Acceptable</p> <p>The O&M activities are complex and an O&M contract is necessary.</p>	<p>No O&M contract: risk of high operational cost overruns beyond mitigants</p> <p>Limited/weak, or local operator dependent on local authorities</p> <p>The O&M activities are complex and an O&M contract is strictly necessary.</p>
<p>(e) Revenue Assessment, including off-take risk¹⁹</p> <ul style="list-style-type: none"> • What is the robustness of the revenue contracts (e.g. off- 	Excellent robustness of the revenues	Good robustness of the revenues	Acceptable robustness of the revenues	The revenues of the project are not certain and there are indications that some of the revenues may not be obtained.

¹⁶ An Operation and Maintenance (‘O&M’) contract refers to a contract between the developer and the operator. The developer delegates the operation, maintenance and often performance management of the project to an operator with expertise in the industry under the terms of the O&M contract (i.e. scope, term, operator responsibility, fees, and liquidated damages).

¹⁷ Performance incentives or performance based contracting refer to strategic performance metrics which directly relate contracting payment to these performance metrics. Performance metrics may measure availability, reliability, maintainability, supportability.

¹⁸ An O&M reserve account refers to a fund into which money is deposited to be used for the purpose of meeting the costs of operation and maintenance of the project.

¹⁹ Off-take risk refers to the risk that the demand for the output or service does not exist at the price at which it is provided or the off-taker is unable or refuses to honour his commitment to purchase the output or service.

<p>take contracts²⁰, concession agreements, public private partnership income stream, and other revenue contracts)? What is the quality of the termination clauses²¹?</p> <ul style="list-style-type: none"> • If there is a take-or-pay²² or fixed-price off-take contract • If there is no take-or-pay or fixed-price off-take contract 	<p>Excellent creditworthiness of off-taker; strong termination clauses; tenor of contract comfortably exceeds the maturity of the debt.</p> <p>Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at projected prices even at lower than historic market growth rates.</p>	<p>Good creditworthiness of off-taker; strong termination clauses; tenor of contract exceeds the maturity of the debt</p> <p>Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices at historical growth rates</p>	<p>Acceptable financial standing of off-taker; normal termination clauses; tenor of contract generally matches the maturity of the debt.</p> <p>Commodity is sold on a limited market that may absorb it only at lower than projected prices</p>	<p>Weak off-taker; weak termination clauses; tenor of contract does not exceed the maturity of the debt.</p> <p>Project output is demanded by only one or a few buyers or is not generally sold on an organised market.</p>
<p>(f) Supply Risk</p> <ul style="list-style-type: none"> • Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength • Reserve risks²³ (e.g. natural resource development) 	<p>Long-term supply contract with supplier of excellent financial standing.</p> <p>Independently audited, proven and developed reserves well in excess of requirements over lifetime of the project.</p>	<p>Long-term supply contract with supplier of good financial standing.</p> <p>Independently audited, proven and developed reserves in excess of requirements over lifetime of the project</p>	<p>Long-term supply contract with supplier of good financial standing — a degree of price risk may remain.</p> <p>Proven reserves can supply the project adequately through the maturity of the debt.</p>	<p>Short-term supply contract or long-term supply contract with financially weak supplier — a degree of price risk definitely remains.</p> <p>Project relies to some extent on potential and undeveloped reserves.</p>

²⁰ An off-take contract refers to a contract between a producer of a resource/product/service and a buyer ('off-taker') of a resource to purchase/sell portions of the producer's future production. An off-take contract is normally negotiated prior to the construction of a facility in order to secure a market for the future output of the facility. The purpose is to provide the producer with stable and sufficient revenue to pay its debt obligation, cover the operating costs and provide certain required return.

²¹ A termination clause refers to a provision in a contract which allows for its termination under specified circumstances.

²² A take-or-pay contract refers to a contract in which it is agreed that a client buys the output or service from the supplier or the client pays the supplier a penalty. Both the price and the penalty are fixed in the contract.

²³ Reserve risk refers to the risk that the accessible reserves are smaller than estimated.

Strength of Sponsor				
(a) Sponsor's track record, financial strength, and country/sector experience	Strong sponsor with excellent track record and high financial standing	Good sponsor with satisfactory track record and good financial standing	Adequate sponsor with adequate track record and good financial standing	Weak sponsor with no or questionable track record and/or financial weaknesses
(b) Sponsor support, as evidenced by equity, ownership clause ²⁴ and incentive to inject additional cash if necessary	Strong. Project is highly strategic for the sponsor (core business — long term strategy)	Good. Project is strategic for the sponsor (core business — long term strategy)	Acceptable. Project is considered important for the sponsor (core business)	Limited. Project is not key to sponsor's long term strategy or core business
Security Package				
(a) Assignment of contracts and accounts	Fully comprehensive	Comprehensive	Acceptable	Weak
(b) Pledge of assets, taking into account quality, value and liquidity of assets	First perfected security interest ²⁵ in all project assets, contracts, permits and accounts necessary to run the project	Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project	Little security or collateral for lenders; weak negative pledge clause ²⁶
(c) Lender's control over cash flow (e.g. cash sweeps ²⁷ , independent escrow accounts ²⁸)	Strong	Satisfactory	Fair	Weak
(d) Strength of the covenant package(mandatory	Covenant package is strong for this type of project Project may issue no additional debt	Covenant package is satisfactory for this type of project Project may issue extremely limited	Covenant package is fair for this type of project Project may issue limited additional	Covenant package is Insufficient for this type of project Project may issue unlimited additional

²⁴ An ownership clause refers to a provision that states that a project cannot be owned by a different entity than the actual owner (sponsor).

²⁵ First perfected security interest refers to a security interest in an asset (mortgaged as a collateral) protected from claims by other parties. A lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.

²⁶ A negative pledge clause refers to a provision that indicates that the institution will not pledge any of its assets if doing so gives the lenders less security.

²⁷ A cash sweep refers to the mandatory use of excess free cash flows to pay down outstanding debt rather than distribute it to shareholders.

²⁸ An independent escrow account refers to an account held in the sponsor's name by a bank under the support of an escrow account agreement between the lender and borrower providing for irrevocable instructions from the borrower to the effect that all operational revenue or proceeds from sale of assets of the project will be paid into this account, and where the bank is authorised to make payments from available funds only as agreed in the project financing documents.

prepayments ²⁹ , payment deferrals ³⁰ , payment cascade ³¹ , dividend restrictions ³² ...)		additional debt	debt	debt
(e) Reserve funds (debt service, O&M, renewal and replacement, unforeseen events, etc)	Longer than average coverage period, all reserve funds fully funded in cash or letters of credit from highly rated bank	Average coverage period, all reserve funds fully funded	Average coverage period, all reserve funds fully funded	Shorter than average coverage period, reserve funds funded from operating cash flows.

Explanatory text for consultation purposes:

Question 5: Do you have any suggestions or comments on the assessment criteria for project finance?

²⁹ A mandatory prepayment refers to a provision that requires the borrower to prepay a portion of the debt with certain proceeds if and when received before the maturity date.

³⁰ A payment deferral refers to a provision that indicates that the borrower is allowed to start making payments at some specified time in the future.

³¹ A payment cascade refers to a provision whereby the project's cash flows are summarised using a cash flow waterfall, which shows the priority of each cash inflow and outflow.

³² A dividend restriction refers to a provision that defines the circumstances in which the lender is able to prevent equity distributions.

Annex 2 – Assessment criteria for Real Estate Exposures

	Category 1	Category 2	Category 3	Category 4
Financial strength				
(a) Market Conditions	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is equal or lower than forecasted demand	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is roughly equal to forecasted demand	Market conditions are roughly in equilibrium. Competitive properties are coming on the market and others are in the planning stages. The project's design and capabilities may not be state of the art compared to new projects	Market conditions are weak. It is uncertain when conditions will improve and return to equilibrium. The project is losing tenants at lease expiration. New lease terms are less favourable compared to those expiring
(b) Financial ratios, i.e. Indicators of the borrower's ability to repay	The property's financial ratios, measured by the property's debt service coverage ratio (DSCR ³³) or interest coverage ratio (ICR ³⁴), are considered strong. DSCR or ICR is not relevant for the construction phase.	The property's financial ratios, measured by the property's DSCR or ICR, are considered satisfactory. The DSCR or ICR is not relevant for development real estate.	The property's financial ratios measured by the property's DSCR or ICR, have deteriorated.	The property's DSCR or ICR has deteriorated significantly.
(c) Advance ratio, i.e. the loan-to-value (LTV³⁵) ratio as an indicators of the borrower's willingness to repay	The property's loan to value ratio (LTV) is considered low given its property type. Where a secondary market exists, the transaction is underwritten to market standards.	The property's LTV is considered satisfactory. Where a secondary market exists, the transaction is underwritten to market standards.	The value of the property has fallen, increasing its LTV.	The property's LTV ratio is well above underwriting standards for new loans.

³³ The Debt Service Coverage ratio ('DSCR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the principal and the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

³⁴ The Interest Coverage Ratio ('ICR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

³⁵ The Loan-to-Value ratio ('LTV') refers to the ratio of the loan amount to the value of the pledged assets.

(d) Stress analysis	The property's resources, contingencies and liability structure allow it to meet its financial obligations during a period of severe financial stress (e.g. interest rates, economic growth)	The property can meet its financial obligations under a sustained period of financial stress (e.g. interest rates, economic growth). The property is likely to default only under severe economic conditions	During an economic downturn, the property would suffer a decline in revenue that would limit its ability to fund capital expenditures and significantly increase the risk of default	The property's financial condition is strained and is likely to default unless conditions improve in the near term
(e) Cash-flow predictability				
<ul style="list-style-type: none"> For complete and stabilized property 	The property's leases are long-term with creditworthy tenants and their maturity dates are scattered, or a public private partnership guarantees a considerable part of the tenancy contracts. The property has a track record of tenant retention upon lease expiration. Its vacancy rate is low. Expenses (maintenance, insurance, security, and property taxes) are predictable	Most of the property's leases are long-term, with tenants that range in creditworthiness. A public private partnership may guarantee part of the tenancy contracts. The property experiences a normal level of tenant turnover upon lease expiration. Its vacancy rate is low. Expenses are predictable	Most of the property's leases are medium rather than long-term with tenants that range in creditworthiness. A public private partnership may guarantee only a minor part of the tenancy contracts. The property experiences a moderate level of tenant turnover upon lease expiration. Its vacancy rate is moderate. Expenses are relatively predictable but vary in relation to revenue	The proportion of short term leases is significant with tenants that range in creditworthiness. The property experiences a very high level of tenant turnover upon lease expiration. Its vacancy rate is high. Significant expenses are incurred preparing space for new tenants
<ul style="list-style-type: none"> For complete but not stabilized property 	The cashflows obtained from the leasing activity, for instance obtained from a public private partnership, meet or exceed the expected cashflows used in the valuation of the property. The project should achieve stabilization in the near future	The cashflows obtained from the leasing activity, for instance obtained from a public private partnership, meet or exceed the expected cashflows used in the valuation of the property. The project should achieve stabilization in the near future	Most of the cashflows obtained from the leasing activity meet the expected cashflows used in the valuation of the property. However, stabilization will not occur for some time	The cashflows obtained from the leasing activity do not meet the expected cashflows used in the valuation of the property. Despite achieving target occupancy rate, cash flow coverage is tight due to disappointing revenue
<ul style="list-style-type: none"> For construction phase 	The property is entirely preleased through the tenor of the loan ³⁶ or pre-sold to an investment grade tenant or buyer, or the bank has a binding commitment for take-out financing from an investment grade	The property is entirely pre-leased or pre-sold to a creditworthy tenant or buyer, or the bank has a binding commitment for permanent financing from a creditworthy lender, for instance through a public private	Leasing activity is within projections but the building may not be pre-leased and there may not exist a take-out financing. The bank may be the permanent lender	The property is deteriorating due to cost overruns, market deterioration, tenant cancellations or other factors. There may be a dispute with the party providing the permanent financing

³⁶ The tenor of a loan refers to the amount of time left for the repayment of a loan.

	lender, for instance through a public private partnership.	partnership.		
Political and legal environment				
(a) Legal and regulatory risks	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts, even if repossession might be long and/or difficult	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible
Asset characteristics				
(a) Location	Property is located in highly desirable location that is convenient to services that tenants desire	Property is located in desirable location that is convenient to services that tenants desire	The property location lacks a competitive advantage	The property's location, configuration, design and maintenance have contributed to the property's difficulties
(b) Design and condition	Property is favoured due to its design, configuration, and maintenance, and is highly competitive with new properties	Property is appropriate in terms of its design, configuration and maintenance. The property's design and capabilities are competitive with new properties	Property is adequate in terms of its configuration, design and maintenance	Weaknesses exist in the property's configuration, design or maintenance
(c) Property is under construction	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is adequate and contractors are ordinarily qualified	Project is over budget or unrealistic given its technical hazards. Contractors may be under qualified
Strength of Sponsor/Developed (including any public private partnership)				
(a) Financial capacity and willingness to support the property.	The sponsor/ developer made a substantial cash contribution to the construction or purchase of the property. The sponsor/developer has substantial resources and limited direct and contingent liabilities. The	The sponsor/ developer made a material cash contribution to the construction or purchase of the property. The sponsor/developer's financial condition allows it to support the property in the event of a cash	The sponsor/ developer's contribution may be immaterial or non-cash. The sponsor/developer is average to below average in financial resources	The sponsor/ developer lacks capacity or willingness to support the property

	sponsor/developer's properties are diversified geographically and by property type	flow shortfall. The sponsor/developer's properties are located in several geographic regions		
(b) Reputation and track record with similar properties.	Experienced management and high sponsors' quality. Strong reputation and lengthy and successful record with similar properties	Appropriate management and sponsors' quality. The sponsor or management has a successful record with similar properties	Moderate management and sponsors' quality. Management or sponsor track record does not raise serious concerns	Ineffective management and substandard sponsors' quality. Management and sponsor difficulties have contributed to difficulties in managing properties in the past
(c) Relationships with relevant real estate actors	Strong relationships with leading actors such as leasing agents	Proven relationships with leading actors such as leasing agents	Adequate relationships with leasing agents and other parties providing important real estate services	Poor relationships with leasing agents and/or other parties providing important real estate services
Security Package				
(a) Nature of lien	Perfected first lien ³⁷	Perfected first lien	Perfected first lien	Ability of lender to foreclose is constrained
(b) Assignment of rents (for projects leased to long-term tenants)	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to remit rents directly to the lender, such as a current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has not obtained an assignment of the leases or has not maintained the information necessary to readily provide notice to the building's tenants
(c) Quality of the insurance coverage	Appropriate	Appropriate	Appropriate	Substandard

³⁷ Lenders in some markets exclusively use loan structures that include junior liens. Junior liens may be indicative of this level of risk if the total LTV inclusive of all senior positions does not exceed a typical first loan LTV.

Explanatory text for consultation purposes:

Question 6: Do you have any suggestions or comments on the assessment criteria for real estate?

Annex 3 – Assessment criteria for Object Finance exposures

	Category 1	Category 2	Category 3	Category 4
Financial strength				
(a) Market Conditions	Demand is strong and growing, strong entry barriers, low sensitivity to changes in technology and economic outlook	Demand is strong and stable. Some entry barriers, some sensitivity to changes in technology and economic outlook	Demand is adequate and stable, limited entry barriers, significant sensitivity to changes in technology and economic outlook	Demand is weak and declining, vulnerable to changes in technology and economic outlook, highly uncertain environment
(b) Financial ratios: DSCR ³⁸ or ICR ³⁹)	Strong financial ratios considering the type of asset. Very robust economic assumptions	Strong / acceptable financial ratios considering the type of asset. Robust project economic assumptions	Standard financial ratios for the asset type	Aggressive financial ratios considering the type of asset
(c) Advance ratio, i.e. Loan-to-value (LTV ⁴⁰) ratio	Strong LTV ratio considering the type of asset.	Strong/good LTV ratio considering the type of asset.	Standard LTV ratio for the asset type	Aggressive LTV ratio considering the type of asset
(d) Stress analysis	Stable long-term revenues, capable of withstanding severely stressed conditions through an economic cycle	Satisfactory short-term revenues. Loan can withstand some financial adversity. Default is only likely under severe economic conditions	Uncertain short-term revenues. Cash flows are vulnerable to stresses that are not uncommon through an economic cycle. The loan may default in a normal downturn	Revenues subject to strong uncertainties; even in normal economic conditions the asset may default, unless conditions improve
(e) Market liquidity	Market is structured on a worldwide basis; assets are highly liquid	Market is worldwide or regional; assets are relatively liquid	Market is regional with limited prospects in the short term, implying lower liquidity	Local market and/or poor visibility. Low or no liquidity, particularly on niche markets
Political and legal environment				
(a) Legal and regulatory risks	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts, even if repossession might be long and/or difficult	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible
Transaction characteristics				
(a) Financing term compared to the economic life of the asset	Full payout profile/minimum balloon. No grace period	Balloon more significant, but still at satisfactory levels	Important balloon with potentially grace periods	Repayment in fine or high balloon
Operating risk				
(a) Permits / licensing	All permits have been obtained; asset	All permits obtained or in the process	Most permits obtained or in process	Problems in obtaining all required

³⁸ The Debt Service Coverage ratio ('DSCR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the principal and the interest payments during the life of the loan, where the cashflow available for debt service shall be calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

³⁹ The Interest Coverage Ratio ('ICR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the interest payments during the life of the loan, where the cashflow available for debt service shall be calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

⁴⁰ The Loan-to-Value ratio ('LTV') refers to the ratio of the loan amount to the value of the pledged assets.

	meets current and foreseeable safety regulations	of being obtained; asset meets current and foreseeable safety regulations	of being obtained, outstanding ones considered routine, asset meets current safety regulations	permits, part of the planned configuration and/or planned operations might need to be revised
(d) Scope and nature of O & M contracts	Strong long-term O&M contract ⁴¹ , preferably with contractual performance incentives, and/or O&M reserve accounts (if needed)	Long-term O&M contract, and/or O&M reserve accounts ⁴² (if needed)	Limited O&M contract or O&M reserve account (if needed)	No O&M contract: risk of high operational cost overruns beyond mitigants
(e) Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset
Asset characteristics				
(a) Configuration, size, design and maintenance (i.e. age, size for a plane) compared to other assets on the same market	Strong advantage in design and maintenance. Configuration is standard such that the object meets a liquid market	Above average design and maintenance. Standard configuration, maybe with very limited exceptions — such that the object meets a liquid market	Average design and maintenance. Configuration is somewhat specific, and thus might cause a narrower market for the object	Below average design and maintenance. Asset is near the end of its economic life. Configuration is very specific; the market for the object is very narrow
(b) Resale value	Current resale value is well above debt value	Resale value is moderately above debt value	Resale value is slightly above debt value	Resale value is below debt value
(c) Sensitivity of the asset value and liquidity to economic cycles	Asset value and liquidity are relatively insensitive to economic cycles	Asset value and liquidity are sensitive to economic cycles	Asset value and liquidity are quite sensitive to economic cycles	Asset value and liquidity are highly sensitive to economic cycles
Strength of sponsor (including public private partnership)				
(a) Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset
(b) Sponsors' track record and financial strength	Sponsors with excellent track record and high financial standing	Sponsors with good track record and good financial standing	Sponsors with adequate track record and good financial standing	Sponsors with no or questionable track record and/or financial weaknesses
Security Package				
(a) Asset control	Legal documentation provides the	Legal documentation provides the	Legal documentation provides the	The contract provides little security to

⁴¹ An Operation and Maintenance ('O&M') contract refers to a contract between the developer and the operator. The developer delegates the operation, maintenance and often performance management of the project to an operator with expertise in the industry under the terms of the O&M contract (i.e. scope, term, operator responsibility, fees, and liquidated damages).

⁴² An O&M reserve account refers to a fund into which money is deposited to be used for the purpose of meeting the costs of operation and maintenance of the project.

	lender effective control (e.g. a first perfected security interest ⁴³ , or a leasing structure including such security) on the asset, or on the company owning it	lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	the lender and leaves room to some risk of losing control on the asset
(b) Rights and means at the lender's disposal to monitor the location and condition of the asset	The lender is able to monitor the location and condition of the asset, at any time and place (regular reports, possibility to lead inspections)	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset are limited
(c) Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance	Weak insurance coverage (not including collateral damages) or with weak quality insurance

Explanatory text for consultation purposes:

Question 7: Do you have any suggestions or comments on the assessment criteria for object finance?

⁴³ First perfected security interest refers to a security interest in an asset (mortgaged as a collateral) protected from claims by other parties. A lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.

Annex 4 – Assessment criteria for Commodities Finance exposures

	Category 1	Category 2	Category 3	Category 4
Financial strength				
(a) Degree of over-collateralisation of trade	Strong	Good	Satisfactory	Weak
Political and legal environment				
(a) Country risk	No country risk	Limited exposure to country risk (in particular, offshore location of reserves in an emerging country)	Exposure to country risk (in particular, offshore location of reserves in an emerging country)	Strong exposure to country risk (in particular, inland reserves in an emerging country)
(b) Mitigation of country risks	Very strong mitigation: Strong offshore mechanisms Strategic commodity 1st class buyer	Strong mitigation: Offshore mechanisms - Strategic commodity Strong buyer	Acceptable mitigation: Offshore mechanisms - Less strategic commodity Acceptable buyer	Only partial mitigation: No offshore mechanisms - Non-strategic commodity Weak buyer
Asset characteristics				
(a) Liquidity and susceptibility to damage	Commodity is quoted and can be hedged through futures or OTC instruments. Commodity is not susceptible to damage	Commodity is quoted and can be hedged through OTC instruments. Commodity is not susceptible to damage	Commodity is not quoted but is liquid. There is uncertainty about the possibility of hedging. Commodity is not susceptible to damage	Commodity is not quoted. Liquidity is limited given the size and depth of the market. No appropriate hedging instruments. Commodity is susceptible to damage
Strength of sponsor (including public private partnership)				
(a) Financial strength of trader	Very strong, relative to trading philosophy and risks	Strong	Adequate	Weak
(b) Track record, including ability to manage the logistic process	Extensive experience with the type of transaction in question. Strong record of operating success and cost efficiency	Sufficient experience with the type of transaction in question. Above average record of operating success and cost efficiency	Limited experience with the type of transaction in question. Average record of operating success and cost efficiency	Limited or uncertain track record in general. Volatile costs and profits
(c) Trading controls and hedging policies	Strong standards for counterparty selection, hedging, and monitoring	Adequate standards for counterparty selection, hedging, and monitoring	Past deals have experienced no or minor problems	Trader has experienced significant losses on past deals
(d) Quality of financial disclosure	Excellent	Good	Satisfactory	Financial disclosure contains some uncertainties or is insufficient
Security package				
(a) Asset control	First perfected security interest ⁴⁴ provides the lender legal control of the assets at any time if needed	First perfected security interest provides the lender legal control of the assets at any time if needed	At some point in the process, there is a rupture in the control of the assets by the lender. The rupture is mitigated by knowledge of the trade process or	Contract leaves room for some risk of losing control over the assets. Recovery could be jeopardised

⁴⁴ First perfected security interest refers to a security interest in an asset (mortgaged as a collateral) protected from claims by other parties. A lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.

			a third party undertaking as the case may be	
(b) Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies

Explanatory text for consultation purposes:

Question 8: Do you have any suggestions or comments on the assessment criteria for commodities finance?

5. Accompanying documents

5.1 Draft Cost- Benefit Analysis / Impact Assessment

5.1.1 Introduction

Article 153(9) of the CRR requires EBA to develop draft regulatory technical standards (RTS) to specify how institutions will take into account the following factors when assigning risk weights to specialised lending: financial strengths, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public and private partnership income stream, and security package.

As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft RTS developed by the EBA – when submitted to the EU Commission for adoption - shall be accompanied by an Impact Assessment (IA) annex which analyses ‘the potential related costs and benefits’. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

This annex presents the impact assessment of the provisions included in the RTS. Given the nature of the study, the IA is high level and qualitative in nature.

5.1.2 Problem definition

The core problem which the RTS aim to address is the lack of a European harmonised framework in the interpretation of circumstances to measure the underlying risks for specialised lending exposures for which the risk weights (RWs) are assigned to them on the basis of set of supervisory risk weights which is specified in Table 1 of Article 153(5) CRR.

The interpretation and the implementation of the factors may vary across Member States and it can be expected that the lack of common standards in assessing the underlying risk of the special lending exposures and in assigning the corresponding RWs could lead to problems, including:

- uneven playing field: *same* specialised lending exposures that are subject to similar circumstances and factors located in two different jurisdictions, can be treated differently if the conditions and the factors for the assessment of the underlying risk and the corresponding RWs are not consistent between jurisdictions,
- distortion in competition: the regulatory framework which provides less strict assessment criteria to the exposures of the institutions gives these institutions an unfair competitive advantage with respect to the institutions operating under strict regulatory framework, and

- obstacles to effective cooperation in supervisory practices: lack of common rules across jurisdictions may lead to different supervisory practices among supervisory authorities. This will in particular, although not only, be relevant when they are handling cross-border cases.

At the larger scale, such problems in the regulatory framework may prevent the effective and efficient functioning of the EU banking sector as well as the Internal Market.

5.1.3 Objectives

The objective of these RTS is to promote (a minimum level of) harmonisation when the institutions assess the risk associated with specialised lending exposures for which they assign risk weights according to Table 1 in Article 153(5) CRR.

A central element to establishing such a harmonised framework is to specify a common set of indicators and conditions which can be used by the authorities across Member States when assessing the underlying risk of the specialised lending exposures of an institution. A common framework is also expected to facilitate cooperation among authorities in EU Member States when they handle cross-border cases. The framework ultimately aims to promote the effective and efficient functioning of the EU banking sector.

5.1.4 Use of slotting criteria across EU

The Basel Committee on Banking Supervision introduced in 2004 a framework for supervisors to determine the capital requirements for specialised lending exposures for which banks do not meet the requirements for the estimation of PD under the corporate IRB approach. These requirements were set out in the 2004 Revised Framework on International Convergence of Capital Measurement and Capital Standards, commonly referred to as Basel II⁴⁵. The Basel standards require banks to map their internal grades to five supervisory categories, each of which is associated with a specific risk weight. Furthermore, the Basel text provides for five sub-classes of specialised lending: project finance (PF), income producing real estate (IPRE), high volatility commercial real estate (HVCRE), object finance (OF) and commodities finance (CF). The Basel text provides detailed supervisory slotting criteria which are specific to the sub-classes of specialised lending. These sub-classes have been transformed into four classes of specialised lending in this Consultation Paper: project finance, real estate (RE), object finance and commodities finance.

Given that there are nine EU Member States of BCBS committed to implement the Basel framework, the supervisory slotting criteria apply at least in these EU member states: Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden and the UK with regard to

⁴⁵ <http://www.bis.org/publ/bcbs107.htm> for the original Basel II text and <http://www.bis.org/publ/bcbs128.pdf?l=en> for the Comprehensive Version of the revised framework (2006).

internationally active banks. Furthermore, the data assembled under the EBA⁴⁶ COREP⁴⁷ templates have been used to get information on the use of slotting criteria by the other EU member states which are not BCBS members. On the basis of the reported data for 2014Q3, EBA found evidence that slotting criteria are also being used for assigning risk weights to specialised lending exposures in: Austria, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Greece, Latvia, Lithuania, Portugal and Slovakia. Tables 1 and 2 summarize the exposure values that are reported by the reporting institutions for specialised lending⁴⁸ under the slotting approach in the COREP database⁴⁹ in 2014Q3⁵⁰, in absolute numbers (millions of euros) (Table 1) and in share of the total amount of exposures under the slotting approach (Table 2). From these tables, one can notice that the slotting approach is used by 45 institutions in 19 different member states. Slotting is used most often (in terms of the number of institutions) in UK (7 institutions), Spain and Germany (6 institutions), Austria and France (4 institutions). When expressed in terms of the magnitude of the exposure value under the slotting approach, 58.6% of SL exposures under slotting are reported by UK banks, followed by 19.34% by institutions in Spain, 9.5% in Austria, and respectively 3.62% and 3.47% in France and Germany. As such, the majority of specialised lending exposures under the slotting approach are reported by institutions in the UK.

Table 1 Specialised lending exposure values under slotting criteria by member state and by category (in EUR millions, 2014Q3 COREP data)

MS	No. of institutions	Category 1	Category 2	Category 3	Category 4	Category 5	Total SL exposures in slotting
Austria	4	4,378	11,549	2,392	1,491	2,737	22,546
Belgium	1	0	20	49	0	54	123
Bulgaria	1	111	166	174	3	248	702
Croatia	1	3	93	1	34	256	387
Czech Republic	1	826	317	78	130	103	1,455

⁴⁶ This Impact Assessment makes use of the reported COREP data under Data Point Model 2.1 for the Framework Release 03/2014 for the ITS on Supervisory Reporting (<http://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/implementing-technical-standard-on-supervisory-reporting-data-point-model-/-/regulatory-activity/consultation-paper>).

⁴⁷ The institutions for which data are reported under the ITS on Supervisory Reporting differs between reporting periods, and is governed by the EBA Decision of 14 May 2014 (<https://www.eba.europa.eu/documents/10180/16082/EBA+DC+090+%28Decision+on+Reporting+by+Competent+Authorities+to+the+EBA%29.pdf/9beaf5be-2624-4e36-a75b-b77aa3164f3f>). In 2014Q3, 156 institutions reported data under the COREP/FINREP templates, representing around 32 000 billion euros of total assets, which is 83.5% of total EU banking assets, where total EU banking assets refers to the total assets held by EU MFIs as reported in the ECB Statistical Data Warehouse for 2013Q4 for domestic banking groups and stand-alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.

⁴⁸ Specialised lending exposures are reported under sheet C 08.01.a (Credit and counterparty credit risks and free deliveries: IRB approach to capital requirements) of the COREP template, more specifically sheets C 08.01.a(090) and C 08.01.a(010) which cover Specialised Lending with (090) or without (010) own estimates of LGD or conversion factors within the Corporate exposure class.

⁴⁹ Note that a zero value has been assumed in the relevant templates where the reported value was a missing value.

⁵⁰ Note that the COREP database covers both institutions that report at consolidated and at solo-level. As a rule, reporting should be done at the highest consolidation level of any given banking group and for non-EEA banking group subsidiaries (<https://www.eba.europa.eu/documents/10180/16082/EBA+DC+090+%28Decision+on+Reporting+by+Competent+Authorities+to+the+EBA%29.pdf/9beaf5be-2624-4e36-a75b-b77aa3164f3f>).

Denmark	1	0	9	3	3	6	21
Estonia	1	5	43	22	28	26	124
France	4	7,336	314	709	95	161	8,615
Germany	6	2,767	3,869	1,154	129	346	8,266
Greece	1	94	855	473	65	667	2,155
Italy	2	202	612	673	147	331	1,963
Latvia	1	5	43	22	28	26	124
Lithuania	1	0	7	1	8	17	34
Luxembourg	1	490	472	79	36	72	1,149
Portugal	1	170	1,297	251	101	141	1,959
Slovakia	3	513	1,135	434	122	186	2,390
Spain	6	11,348	24,533	5,332	1,424	3,415	46,052
Sweden	2	17	337	60	71	56	542
United Kingdom	7	51,862	40,334	14,889	6,453	25,915	139,453
Total	45	80,128	86,005	26,796	10,367	34,764	238,060

Note: The following risk weights apply to the categories 1 to 5 in Table 1, according to Article 153(5) CRR:

Cat 1: 50% (maturity below 2.5 years) and 70% (maturity equal to or above 2.5 years); Cat 2: 70% (maturity below 2.5 years) and 90% (maturity equal to or above 2.5 years); Cat 3: 115%; Cat 4: 250%; Cat 5: 0%.

Table 2 Specialised lending exposure values under slotting criteria by category as a share of total specialised lending exposures under slotting criteria by member state (in percent, 2014Q3 COREP data)

Member state	No. of institutions	Category 1	Category 2	Category 3	Category 4	Category 5
Austria	4	19%	51%	11%	7%	12%
Belgium	1	0%	17%	40%	0%	44%
Bulgaria	1	16%	24%	25%	0%	35%
Croatia	1	1%	24%	0%	9%	66%
Czech Republic	1	57%	22%	5%	9%	7%
Denmark	1	1%	44%	13%	12%	29%
Estonia	1	4%	34%	17%	23%	21%
France	4	85%	4%	8%	1%	2%
Germany	6	33%	47%	14%	2%	4%
Greece	1	4%	40%	22%	3%	31%
Italy	2	10%	31%	34%	7%	17%
Latvia	1	4%	34%	17%	23%	21%
Lithuania	1	0%	21%	3%	25%	51%
Luxembourg	1	43%	41%	7%	3%	6%
Portugal	1	9%	66%	13%	5%	7%
Slovakia	3	21%	48%	18%	5%	8%
Spain	6	25%	53%	12%	3%	7%
Sweden	2	3%	62%	11%	13%	10%
United Kingdom	7	37%	29%	11%	5%	19%
Total	45	34%	36%	11%	4%	15%

Note: The following risk weights apply to the categories 1 to 5 in Table 1, according to Article 153(5) CRR:

Cat 1: 50% (maturity below 2.5 years) and 70% (maturity equal to or above 2.5 years); Cat 2: 70% (maturity below 2.5 years) and 90% (maturity equal to or above 2.5 years); Cat 3: 115%; Cat 4: 250%; Cat 5: 0%.

The slotting approach is not the only approach to determine capital requirements for specialised lending exposures. Indeed, the CRR sets out in Art 153(5) CRR that for those specialised lending

exposures for which the institution is not able to estimate the PD, or the PD estimations do not meet the PD requirements in the CRR, the institution should assign risk weights according to the table specified in Article 153(5) CRR. As such, one can disentangle three approaches for assigning risk weights to specialised lending exposures: the Foundation IRB approach (where the institution does not use own estimations of LGD and conversion factor), the Advanced IRB approach (where own estimations of LGD and conversion factor are used), and supervisory slotting criteria, which are the subject of these RTS. In terms of magnitude of the exposures within each of these approaches, the COREP data⁵¹ (of 2014Q3) indicate that 28% of the SL exposures falls under the F-IRB approach, 48% under the A-IRB approach, and 23% under the slotting approach (see Table 3).

Table 3: Specialised lending exposure values under slotting, F-IRB and A-IRB (in EUR millions and in percentage, 2014Q3 COREP data)

Approach	Exposure value	Share in total SL
Specialised lending under F-IRB	291,126.00	28%
Specialised lending under A-IRB	496,045.30	48%
Specialised lending under slotting	238,001.40	23%
Total amount of specialised lending exposure value	1,025,172.70	

It should also be noticed that specialised lending exposures fall within the IRB corporate exposure class, where they represent a share of 11% of the total exposure values in this class (see Table 4).

Table 4: Exposure values in the corporate exposure class (in EUR millions and in percentage, 2014Q3 COREP data)

	Exposure value	Share in total corporate exposure class
Corporate - SME	1,305,825.60	19%
Corporate - SL	787,171.30	11%
Corporate - other	4,856,533.70	70%

⁵¹ Note that the number of institutions reporting data under the corporate exposure class is 101 (i.e. smaller than the 156 institutions which report COREP data in 2014Q3) because not all institutions reported data in this exposure class (i.e. some institutions reported no values, i.e. blanks).

Total corporate	6,949,530.60
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On the basis of the COREP data, it is however not possible to differentiate among the classes of specialised lending (i.e. project finance, real estate, object finance and commodities finance). As such, the information in these templates is the aggregate of all classes (in those member states that differentiate between different classes of specialised lending).

5.1.5 Assessment of the technical options

Given the widespread use of the Basel supervisory slotting criteria, it has been considered the logical policy choice to draft this Consultation Paper for the RTS on the basis of the Basel supervisory slotting criteria for Specialised Lending. This means that this Consultation Paper has taken over the Basel sub-classes of specialised lending to minimise the impact for institutions, with the exception of the distinction between IPRE and HVCRE which have been combined into one category of specialised lending, because no different treatment is allowed in the CRR for either type. As such, this Consultation Paper allows for four classes of specialised lending: project finance, real estate, object finance and commodities finance.

It should however be noticed that the Basel text does not specify how the assignment of specialised lending exposures according to the different factors should be combined in order to make the final assignment to a category. The main policy choice is therefore whether this Consultation Paper for the draft RTS should harmonise the combination of the different factors. If it is chosen to also specify the combination of factors, the second and related policy choice is how this should be done.

With respect to the first policy choice, the table below summarises the main advantages and disadvantages of either approach.

Table 5: Potential advantages and disadvantages of harmonising the combination of factors

	Potential benefits / advantages	Potential costs / disadvantages
No harmonisation of the combination of the different factors	A certain level of supervisory discretion is retained	Discretion of supervisors may create uncertainty for the market players
	Harmonisation is achieved through the specification of common factors	A lack of consistency across jurisdictions may develop, leading to diverging capital requirements
	Allows an approach that is tailored to the specific exposure, which potentially enhances the risk sensitivity	Great variations may make the cross-border cooperation less efficient and effective
Harmonisation on the combination of the different factors	Higher level of convergence is achieved across jurisdictions	Supervisory discretion is more limited; some exposure-specific considerations could potentially not fully be taken into account

<p>More clarity and transparency is provided to market participants as well as institutions</p>	<p>Harmonising the combination of the different factors puts a constraint to the models used by institutions. Given that specialised lending is still within the IRB approach, it could be argued that no constraints should be put on the combination of the factors</p> <p>There are costs for the institutions associated to introduction of new regulatory requirements by institutions.</p>
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On the basis of the advantages and disadvantages discussed in the table above, it is reasonable to conclude that harmonising the combination of the different factors would to a certain extent contribute to a greater consistency of capital requirements at a minimum cost. It is therefore the most cost-effective approach. As such, this Consultation Paper puts forward two alternative options for how the different factors should be combined, as outlined in Article 1(3). Both suggested approaches do not fix the combination of factors completely, but set some constraints to this combination of factors.

In the first option, a relatively straightforward rule is proposed, whereby the final assignment to a category can only be at most one step lower than the cardinal number of the highest category of all factors. However, in line with the specification in the CP for the draft RTS on assessment methodology for IRB approach, overrides would be allowed in certain circumstances, but should be documented, and the performance of these exposures should be analysed. The advantage of this rule is its simplicity, as well as the possibility to accommodate for special circumstances, and it would allow a prudent assessment of the underlying credit risk for all specialised lending exposures subject to the approach in Article 153(5) of Regulation (EU) No 575/2013. One potential disadvantage of this option is that the final assignment of an exposure may only be determined by one or a few factors, meaning that not all factors determine the final assignment.

In the second option, the institutions are required to specify the weight that it assigns to each factor in order to determine the final assignment to a category. This option requires that the institution determines the final assignment to a category on the basis of the weighted average of the cardinal numbers of the categories all factors have been assigned to, where a minimum weight of [10%] should be applied to each factor. The institution should then round this number up or down, when required, in order to determine the final assignment of the exposure to a category. The practical implementation of this option is potentially less straightforward than the first option, but it has the advantage of being clear and transparent. Furthermore, this option rules out that institutions would discard one or several factors in the assignment to a category. EBA would like to consult the industry and other stakeholders on the feasibility of specifying weights to the factors and putting a [10%] floor to this weight.

The input obtained from the industry will be used in order to choose one of the above suggested options to be included in the final draft RTS or any additional option provided by the industry.

Explanatory text for consultation purposes:

Question 9: Do you have any suggestions or comments on the Impact Assessment?

5.2 Overview of questions for Consultation

Question 1: What are the operational challenges of using the slotting approach? Is it possible to obtain comparable capital requirements across institutions using the slotting approach? Should the slotting approach in your view be extended to other types of exposures, if yes, which types of exposures would this be particularly relevant for?

Question 2: What would be the preferred approach for the combination of the factors into a final assignment to a category? What are the advantages and drawback of either approach? Are both options equally clear or should further guidance be provided? Are there other approaches that could be used to harmonise how the different factors are combined into a final assignment for the risk weight?

Question 3: Do you agree with the classification of specialised lending and the descriptions given?

Question 4: Do you agree with these documentation requirements for each specialised lending exposure for which risk weights are assigned according to this Regulation?

Question 5: Do you have any suggestions or comments on the assessment criteria for project finance?

Question 6: Do you have any suggestions or comments on the assessment criteria for real estate?

Question 7: Do you have any suggestions or comments on the assessment criteria for object finance?

Question 8: Do you have any suggestions or comments on the assessment criteria for commodities finance?

Question 9: Do you have any suggestions or comments on the Impact Assessment?