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EBF response to the EBA Consultation on Draft RTS on the allocation of off-balance sheet items and UCC considerations under article 111(8) of Regulation (EU) No 575/2013

GENERAL COMMENTS

The treatment of OBS items is fundamentally changing as a consequence of the revised level 1 text in Art 111 and Annex I of the CRR3.

Further, the text and the examples in the RTS go well beyond the mandate of categorizing items "*with the exception of items already included in Annex I*", as stated in article 111(8) and should not cover such items, notably for mortgage loan offers and other commitments.

The proposed RTS introduces changes which we believe go far beyond those introduced by the 2017 Basel agreements. As referred in the Annex I of this document, only CCF applicable to commitments subject to the former 20/50% CCF, based on initial maturity, moved a 40% CCF bucket. **We believe the EBA should not introduce significant changes to the other buckets as it may lead to a significant increase in capital requirement for banks, in contradiction with the *"no significant increase"* objective endorsed by EU institutions. This is all the truer that these impacts have not been captured by the different impact studies.**

The formulation of article 1.1 of the draft RTS is extremely wide. Indeed, the literal reading of this article would mean that any off-balance sheet item not linked to a non-credit related event would fall under the bucket 1category, including a financing commitment or a revolving credit facility, while we understand, based on the background document, that the EBA is targeting credit substitute guarantees or part of financing commitments with mandatory drawings. **We therefore suggest EBA to modify Article 1.1 by precising that it applies to contingent commitments and not to financing commitments.**

Similarly, article 1.2 as currently drafted will capture all the other off-balance sheet items that are not trade finance related and whose materialization is contingent to a non-credit risk related event that has not yet occurred. For instance, this bucket will capture a financing commitment whose possible drawdown is linked to an administrative agreement, while this type of commitment should be captured under the bucket 3 (40% CCF). **We suggest the EBA to modify article 1.2 by precising that this article should apply only to contingent transaction-related commitment (excluding trade finance commitments) which are not financing commitments.**

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Instead, it could be understood, given the current formulation made by the EBA, that no financing commitment could fall in category 3 (40% CCF) since the 2 first buckets would capture all of them, except the requalified UCC (see below).

Moreover, we consider article 1.3 as currently drafted goes beyond the Level 1 text by assigning a specific bucket to mortgage offer loans, considering the Level 1 text already covers the CCF to be assigned to commitments when reference is done to the Annex I. We suggest the EBA to delete article 1.3 or to assign, instead, the CCF to bucket 3.

Some factors proposed by the EBA for the disqualification of UCC are highly subjective and-the same as the one used by the BCBS to justify a 10% CCF.

As a first step, we would like to underline that two factors listed by the EBA have been used by the Basel Committee precisely to justify the increase of CCF from 0% to 10%.

2014 BCBS Consultation paper quote:

*"Commitments that a bank may cancel unconditionally and at any time without prior notice, or that effectively provide for automatic cancellation due to the deterioration in a borrower's creditworthiness, currently receive a 0% CCF. However, consumer protection laws, **risk management capabilities and reputational risk considerations may constrain banks' ability to cancel such commitments**. For this reason, the Committee believes a 0% CCF is inappropriate and proposes a new CCF of 10% for such exposures."*

We believe the EBA, by proposing, not only the same factors suggested by the BCBS (which in turn used them to explain the CCF increase from 0% to 10%) to justify the **CCF increase from 10% to 40% along with the applicable CCF when these factors are met, makes strategic decisions and policy choices in contradiction with EU law and in particular its founding regulation[1].**

Besides, the proposed factors (reputational and commercial motivations), are highly discretionary, subjective and not quantifiable.

Lastly, the EBA goes beyond Level 1 text by assigning a (high) CCF to UCC that would be subject to the factors listed in Article 2.

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RESPONSES TO THE QUESTIONS LISTED IN THE CONSULTATION PAPER

Question 1. *Do you have any comment on the non-exhaustive list of examples provided?*

We welcome the EBA's approach considering the type of underlying obligation and the contingency to a non-financial event to determine the CCF to be applied to the instruments. However, we note that the EBA has proposed a list of items, while CRR mandate only allows for setting criteria of allocation of off-balance sheet items not listed in Annex I. We want to highlight that no sort of additional binding listing can eventually be legally added in the final RTS in any way. Some items mentioned in the document are already allocated in Annex I and thus, out of scope of the mandate.

Please find below our specific concerns, notably in regards of items that are already listed in Annex I for which further guidance from the EBA would be in breach of the mandate:

- **Specific issues with documentary credits:**

Documentary credits are by definition generally short-term, whether there is a collateral or not. We believe it should be clarified that the examples provided in the non-exhaustive list for documentary credits under bucket 2 (50%) do not disallow those documentary credits already recognized in CRR Annex I, under bucket 4 (20%).

According to the bucket 1 examples presented in the RTS, contingent items "where all relevant non-credit risk related conditions have been triggered that previously prevented exposing the institution to the risk of credit losses in case of default of the obligor, and the institution's guarantee is only conditional on a default event for the guaranteed credit obligation" move to bucket 1 with a CCF of 100%.

In case of documentary credits with deferred payment (payment usually 30, 60 or 90 days after presentation of the agreed documents) a narrow interpretation of the paragraph above could lead to a shift to bucket 1 because with the presentation of the documents the non-credit risk related event is triggered.

We approve of the general direction to promote and facilitate trade finance. The new implications of the RTS, however, contradict this very notion by penalizing documentary credits with deferred payment by moving them to bucket 1 with a CCF of 100% for a portion of their life span. The additional costs connected with the higher CCF will adversely affect trade finance as a whole, making it less attractive for both banks and importers.

We therefore kindly ask for clarification that documentary credits in general, with or without deferred payment, should stay in their original bucket for their entire duration.

Further, Bucket 4 of Annex I list "– Short-term, self-liquidating trade letters of credit arising from the movement of goods, in particular documentary credits collateralised by the underlying shipment, in case of an issuing institution or a confirming institution;" the wording "in particular" does not restrict the eligibility to the 20% CCF to L/C that are collateralized. Therefore, non-collateralized L/C are already listed as eligible for the 20% CCF treatment and should not be transferred to bucket 2.

- **Forward starting loans**

As detailed by EBA, it is a financing commitment – a commitment non listed in other buckets is to be assigned to bucket 3. Further, a forward starting loan can also be used to renew a loan in a future date (when the current loan ends). Therefore, it would not be appropriate that this forward starting loan, which aims to renew the loan, be also subject to a 100% CCF, as double counting should be avoided.

Moreover, in the case of forward-starting loans, where the agreed conditions stipulate that the customer must draw down certain amounts at certain times, it is also common for the conditions to stipulate that drawdowns may only be made if it can be expected that the borrower will be able to meet the payment obligations. Thus, the timing of the call is not at the debtor's discretion and the possibility of the debtor making a call is subject to the condition that no default occurs. In other words: If the debtor defaults, it cannot be drawn upon. The institution is therefore only exposed to the debtor's default once the drawdown has taken place on the specified drawdown date.

- **Contingent items where the conditional event that prevents exposing the institution to the risk of credit losses in case of a default has not been triggered yet, but it is related to credit risk, and the institution's guarantee is only conditional on a default event for the guaranteed credit obligation**

This item is misleading; for instance, performance bonds are already listed in Annex I Bucket 2/4: even if the failure in contractual obligation triggering the activation of the guarantee may be linked to credit risk but amongst other reasons, the default of the obligor shall not be considered as the only condition and such items should not be transferred to bucket 1.

- **Treatment of factoring**

We believe that the example under bucket 3 on undrawn amounts of factoring arrangements is not reflecting the nature and specificities of the factoring business and their limits and hence, should be removed from the list.

Most factoring limits are provided on an uncommitted basis. This is still the case under the new definition of commitments as the arrangements fulfil Art. 5 (10) a) – e) CRR3. Hence these limits are out of scope of CCF application.

But even if they were in scope, they were to be seen as UCCs and would be classified in bucket 5. Hence, there is no room to list this as an example in bucket 3.

Question 2. Which is the average period of time given to the client to accept the mortgage loan offer?

Unlike consumer credits, the borrowers (i.e., natural persons), do not have a right of withdrawal (the period during which a borrower may reconsider his decision), but a **right of reflection** which allows them to examine the credit proposals, compare them with any other proposals and decide in full knowledge of the facts.

Question 3. What is the applicable percentage that institution currently apply to these commitments?

We would like to remind the EBA that in the current Annex I of CRR3 as voted at the EU parliament, mortgage loan offers for which the drawdown is not certain, cannot be assigned to bucket 1, 2, 4 or 5 since treated as a commitment as per 111.4. It should thus be assigned to bucket 3 “Commitments, regardless of the maturity of the underlying facility, unless they fall under another category;”, i.e., just like where accepted and undrawn mortgage loans are currently assigned by CRRIII in accordance with Basel statement. Note that this reasoning stands for any type of financing commitments.

Note the EBA Q&A 2022_6602 on “Estimation of a conversion factor for binding mortgage offers under the IRB Approach” specified that binding mortgage proposals qualify for the creditor as agreements to lend (Medium or Medium/low risk depending on the initial maturity of the offer, that has been merged into bucket 3 – 40% CCF in CRR3). It is clarified therein:

> *For institutions using internal model approaches for credit risk, Article 166(8)(d) provides for the determination of the exposure value of “other credit lines” that are not subsumed under more specific definitions of “credit lines” in letter (a), (b) or (c) of that paragraph.*
>
> *All off-balance sheet items that cannot be subsumed under Article 166(8)(a) to (d) shall in turn be treated under Article 166(10) CRR.*
>
> *Since binding proposals for mortgage offers cannot be considered a “credit line”, these items should be treated in accordance with Article 166(10) CRR.*
>
> *With particular regard to the binding proposals pursuant to Article 14(6) of Directive 2014/17/EU, during the period where the consumer can exercise a right of withdrawal (‘after the conclusion of the credit agreement’ but before funds have been released) or during the reflection period (‘before the conclusion of the credit agreement’, although the offer is binding on the creditor), binding mortgage proposals qualify for the creditor as agreements to lend, and therefore have to be classified as a medium/low risk item under point (3.)(b)(i) of Annex I CRR, provided that the maturity is less than one year.*

Allocation to bucket 1 as proposed by the EBA under Art 1(3) would significantly increase the RWA on such items considering current EBA recommendation. Modifications brought by CRR3 to Annex I don't show, in the elements added to bucket 1 (or even 2), any elements assimilated to a mortgage loan offer, confirming that the substance of EBA Q&A is still valid. This is also aligned with the changes introduced by the Basel committee in the allocation of off-balance sheet commitments where the only change introduced by the Basel III finalization in this allocation was the merger of the former bucket 2 (50% CCF) and 3 (20% CCF) into the bucket 3, for commitments. (See Q5, Art 1(3))

Question 4. What is the average acceptance rate by the client of a mortgage loan offered by the bank?

The EBA is going beyond its mandate by contradicting CRR3 that currently allocates mortgage loan offers to the bucket 3, given that in our opinion undrawn mortgage loan accepted by the client already falls into this category. In fact, regardless of statistical average, the application of a 100% CCF ahead of acceptance and even ahead of drawing once the mortgage offer is accepted is potentially incoherent with the legal framework of some jurisdictions.

For example, as per MCD transposition in some jurisdiction and as already mentioned hereabove:

i) once the offer is made by the bank, the client has a right of reflection as mentioned under Q2 - meaning there may also be contingency in relation to the fact that the client does not accept another offer from another bank (as acknowledged by the EBA);

ii) once accepted, the client can still revoke the contractual agreement (without penalty), should the real estate sale not occur.

A 100% CCF means that every offer made by a bank will be accepted by every client. As a result, all banks contacted by the client, within its legal right to compare different offers, would consume capital for a single mortgage. This demonstrates that the average acceptance rate is under 100%. Hence, a 100% CCF is disproportionate, and does not reflect the actual risk of institutions.

The customer's right to compare means that there is no certainty on the final acceptance, so the CCF should not be 100%.

It is our understanding of level 1 text, that the intention of the regulator is to assign a CCF to these offers, but not necessarily a 100%.

Question 5. Do you have any comment on the allocation criteria proposed under Article 1?

- **On Art. 1(1)**

According to Annex I of the CRR, commitments should either be assigned to category 5 (unconditionally cancellable commitments) or category 3 (commitments, regardless of the maturity of the underlying facility). In our opinion, the allocation of commitments to the categories in Annex I is thus conclusively regulated in the CRR. Also, according to para. 13 of the consultation paper, commitments should be assigned to categories 3 or 5. As the EBA correctly states there, this allocation results from the explicit requirements in Annex I of the CRR for these categories, namely that commitments that do not fall under another category fall under category 3, while commitments that can be cancelled at any time must be allocated to category 5. In our opinion, a more extensive regulation within the framework of an RTS would exceed the mandate in Art. 111(8) (a) CRR III, according to which the EBA may only classify off-balance sheet transactions that are not already included in Annex I of CRR III.

Moreover, given the criteria proposed by EBA, we question which commitments would remain eligible to bucket 3. The formulation used in Article 1.1 is too wide as it encompasses any financing commitment whose possible drawdown does not depend on the materialization of a non-credit event. It should be clarified in article 1.1 that it only applies to general guarantees and/or direct credit substitutes.

Indeed, for many financing commitments (revolving credit facilities, overdraft, …), the exposure to credit losses in case of default is not contingent to a non-credit risk related event but to a drawdown which is far from being certain: EBA further states that drawing from a commitment shall not be considered as a non-credit risk related event. Thus, any drawdown exposing the bank to a credit loss but only subject to client’s need of funding could fall in the 100% bucket, which simply ignores the concept of CCF as a probability of drawing. We note that the EBA’s actual policy intention as stated in the background section of the consultation does not seem to align with the drafting of Article 1.1.: the latter (and article 1.2 as well) should only address off balance sheet items in the form of contingent commitments, not any form of financing commitments.

- **On Art. 1(2)**

The EBA assigns off-balance sheet items to 50% CCF where the institution's exposure to the risk of credit losses in the event of default of the obligor is contingent to at least one non-credit risk related event that has yet to occur. We are of the opinion that the performance of a service is not to be interpreted as credit risk related event. Otherwise, performance bonds would not meet the aforementioned condition and thus have to be assigned to bucket 1, which would contradict the level 1 text. Indeed, the failure in the fulfilment of a contractual obligation is a first order non-credit risk related event even if it might be concomitant to the default of the obligor. For instance, a performance bond, whereby the issuer insures the due delivery of goods or services to the buyer, can only be called if the seller has failed to properly finalize the production/delivery. This type of items shall remain in bucket 2 (or 4 when relevant) as already included in Annex I, even if this failure could be, amongst other possible triggers, linked to financial distress.

Similarly, the current phrasing of Article 1(2) may lead to include any financing commitment which gives rise to an exposure to credit losses in case of default after a drawing has been done thanks to the materialization of a non-credit risk related event such as: administrative compliance, proof of work achievement, etc.

Overall, buckets 1 and 2 should not cover financing commitments since they are supposed to fall in the bucket 3. It should also be clarified that the failure in the fulfilment of a contractual obligation is a first order non-credit risk related event even if it might be concomitant to the default of the obligor. For instance, a performance bond, whereby the issuer insures the due delivery of goods or services to the buyer, can only be called if the seller has failed to properly finalize the production/delivery. This type of items shall remain in bucket 2 (or 4 when relevant) as already included in Annex I, even if this failure could be, amongst other reasons, linked to financial distress.

Moreover, the occurrence of the non-credit-risk-related event will, in most cases, be concomitant with the drawing of the guarantee and a recording, from an accounting perspective, as a balance sheet exposure (and therefore equivalent to the application of a 100% CCF).

- **On Art. 1(3)**

We understand that EBA proposes an allocation in bucket 1 to contractual arrangements not yet accepted by the client. We believe that undrawn mortgage loans (accepted or not) shouldn't receive a 100% CCF because clients generally have different offers, which includes legal delays of retractation and because the drawdown is also conditional to the acquisition of the property and therefore is not certain.

The definition of a commitment brought by CRRIII relies on the acceptance of a contractual arrangement by the client and Article 111.4 CRR3 specifically aims at specifying that, even if not yet accepted by the client, the item should be treated in all cases as a commitment. There is no intent here to impact the CCF that is to be applied to the given type of commitment as per Annex I.

That would mean, mortgage loan offers should thus be assigned to bucket 3 "Commitments, regardless of the maturity of the underlying facility, unless they fall under another category;", i.e., just like where accepted and undrawn mortgage loans are currently assigned by CRRIII in accordance with Basel statement.

Therefore, we consider Article 1.3 exceeds the EBA mandate considering that commitments are already covered by Annex I, as per article 111(4) CRR3 when linked its CCF to article 111(2) CRR3.

> *Art 111(4) CRR3: "Contractual arrangements offered by an institution, but not yet accepted by the client, that would become commitments if accepted by the client, shall be treated as*

commitments and the percentage applicable shall be the one provided for in accordance with paragraph 2".

Art 111(2) CRR3: "The exposure value of an off-balance sheet item listed in Annex I shall be the following percentage of the item's nominal value after the deduction of specific credit risk adjustments in accordance with Article 110 and amounts deducted in accordance with Article 36(1), point (m): (a) 100 % for items in bucket 1; (b) 50 % for items in bucket 2; (c) 40 % for items in bucket 3; (d) 20 % for items in bucket 4; (e) 10 % for items in bucket 5".

Therefore, we primarily suggest deleting article 1.3 of the proposed RTS as it would be already covered by CRR3, therefore out of scope of the mandate for developing these RTS.

In case the EBA considers the article should be retained, we would suggest redrafting article 1.3 to properly assign a bucket 3 for these kinds of commitments:

*"3. Commitments whereby the client must draw certain amounts in the future shall **be assigned to bucket 3** referred to in Annex I to Regulation (EU) No 575/2013 within the limits of those amounts".*

We would like to recall here again that any financing commitment CCF is already allocated in Annex 1 (bucket 3 – 40% CCF or Bucket 5 – 10% if UCC), thus allocating it to a CCF higher than 40% would be a deviation from the Basel text: *"A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF."*

EBA's view might only be deemed appropriate if the client has indeed a contractual obligation to use the funds the bank has committed to provide but this would still go beyond the mandate in our opinion as per the above.

Basel III finalization that has only merged some of the 20% and 50% bucket elements into the 40% CCF Bucket (see Annex I). Hence, we consider that financing commitments (such as agreements to lend or purchase assets that are not contingent to any non-credit event and without any contractual obligation of drawing from the client) shall in any circumstances be allocated to Bucket 3.

Question 6*. Do you have any suggestion regarding allocation criteria for buckets 4 and 5?*

In case of documentary credit, those documentary credits which are trade finance by definition are already listed in bucket 4 and should therefore receive a 20% CCF.

The inclusion of these instruments as an example of an item assigned to bucket 2 and the differentiation according to the existence of a documentary collateral, disregarding their Trade Finance nature, creates confusion regarding the prevailing assignment criteria. On the one hand these instruments are by nature Trade Finance associated to bucket 4 and furthermore they are already defined in this bucket.

In the same line, tax, shipping and customs guarantees that are trade finance and can be linked to commercial transactions while depending on the technical performance of a company before being claimed by the beneficiary should fit within bucket 4 definition.

Question 7. Do you have any comment on the factors that may constrain unconditionally cancellable commitments proposed under Article 2?

- **On regulatory overreach**

The EBA introduces factors to be assessed which may constrain banks' ability to cancel the commitment in practice, e.g. commercial considerations aimed at avoiding negative impacts on the creditworthiness of obligor or litigation risks. We appreciate that the CRR II explicitly mandates EBA to do so. However, the specifications of these factors should not lead to a significant gold plating.

Some of the factors proposed by EBA were already identified by the Basel Committee to justify the CCF increase from 0% to 10%[1]. To some extent the 10% CCF recognize that UCC may not always be cancelled. By proposing, the same factors as the one used by the Basel Committee to justify the increase from 0% to 10%, to justify the CCF increase from 10% to 40% EBA creates some kind of double counting. By setting the applicable CCF when these factors are met, the EBA goes far beyond the mandate it has been given.

We believe that these factors are discretionary and highly subjective, and potentially institutions will never be able to demonstrate that they objectively don't exist, which creates regulatory uncertainty for institutions in case of disagreement with their supervisors. We therefore suggest EBA to clarify that its expectations are not that banks should demonstrate, for a given facility or type of facility, that these factors don't exist but instead banks would have to consider assigning a UCC facility to a higher bucket if they identify that these factors exist and are material.
In fact, by applying the same policy principle based on this EBA guidance, less products would qualify for 10% CCF and instead 40% CCF would have to be applied, de-facto restricting the use of the 10% CCF foreseen in the level 1 text to very few or even no cases at all in practice - and thus undermining the level 1 text. Instead, the factors should be specified in a way that maintains the intention of the level 1 text and enables banks to actually assess them in a meaningful manner prior to default.
Moreover, if some factors prevent from the qualification of UCC, the item should go back to the bucket of the category of items to which it belongs. For instance, a UCC which is also a trade finance item would be forced to be subject to a 40% CCF based on the EBA proposal whereas there is no reason for preventing it from benefitting of a 20% CCF. No single mandatory CCF shall be imposed because of failures in regards of the constraining factors.

[1] BCBS consultative document, revisions to the standardised approach 2014: *"Commitments that a bank may cancel unconditionally and at any time without prior notice, or that effectively provide for automatic cancellation due to the deterioration in a borrower's creditworthiness, currently receive a 0% CCF. However, consumer protection laws, risk management capabilities and reputational risk considerations may constrain banks' ability to cancel such commitments. For this reason, the Committee believes a 0% CCF is inappropriate and proposes a new CCF of 10% for such exposures."*

- **On the inclusion of commercial consideration**

Art. 2(b) appears to be inappropriately broad and in effect overly restrictive (commercial considerations aimed at avoiding negative impacts on the creditworthiness of obligor or on the business relationship). Indeed, the "commercial considerations" criterion (b) is unlikely to be refutable in practice. It is unclear what specific measures the EBA has in mind here.

- **On the inclusion of litigation and reputational risks**

We are especially concerned about the inclusion of litigation and reputational risks. These risks are nearly impossible to avoid in any banking product, but the potential presence of these risks does not automatically or necessarily mean that the entity doesn't keep the possibility to cancel them unilaterally. Moreover, both risks are already included in the prudential framework, via Pillar 2, so they should not be included in Pillar 1 through CCFs.

Therefore, we consider litigation risks factor should be excluded from the list considering there is always the risk of litigation, a bank is not run on the basis of litigation.

While we understand the proposed wording comes from the Basel Committee provision under CRE 20.100, more clarity on who is going to assess the proposed factors and how these factors are going to be reviewed/proven would be welcome.

The reference to jurisdiction in para 14 is also unclear when defining that national supervisors should evaluate various factors in the jurisdictions […]. We would appreciate clarity on whether supervisors would consider those factors at bank level or at geographical level.

- **On the inclusion of deficiencies in the risk management procedure**

It is noteworthy that deficiencies in the risk management procedures are already captured by Pillar II requirements and should thus not affect CCF assignment through a too broad factor of assessment. Nevertheless, one could set some criteria linked to the risk management processes that would allow (or not) to fall in the UCC category of items that effectively provides for automatic cancellation due to deterioration in client's creditworthiness. For instance, any credit facility that meets the following conditions shall remain allocated to bucket 5:

i) it contractually provides for cancellation in case of client's creditworthiness deterioration and

ii) is subject to a risk management process which allows that the credit deterioration is detected in a timely manner and that there is no substantial time lag between the observed deterioration and the cancellation of the line.

Other situation may be seen as not being automatically effective ones. For instance, a contract that could be automatically cancelled in case of liquidation only would not meet the condition since the credit deterioration allowing for cancellation is too deep to constrain drawing and thus to justify a low likelihood of drawing over the one-year period prior default.

Moreover, we believe that further clarity is needed in the following terms:

1) The conditions should not be affected by the national legal framework of each country, as long as the bank has the contractual right to cancel the commitment at any time. For this reason, we are of the opinion that national contracting regimes - and litigation/commercial risks derived from these national legal frameworks (for example, consumer protection rules) - should not be considered as factors that may unconditionally constrain cancelable commitments.

2) Also, more clarity is needed on how to assess these factors and the EBA should clearly limit the actual events that would trigger the constraining factors to avoid introducing undue volatility in the own funds' requirements consumption, by introducing objective events that would deactivate the UCC eligibility and to promote a harmonized application across entities.
   E.g.
   - Deficiencies in risk management procedures would arise in case of a supervisory decision of high severity entailing a limitation.
     However, it should not trigger the UCC non-eligibility for instance, having an Internal Audit Recommendation being issued, that could be resolved in a 6 months/ 1 year time. Otherwise, there is a risk of artificially distorting the RWA consumptions due to a too frequent eligibility re-classification).

***Question 8**. Do you have any comment on the notification process proposed under Article 3?*

The notification process (Article 3) refers to the supervisory reporting regulation 2021/451 but it is not clear what specifically is the notification process being referred to. Can this be clarified?

It also would be important to clarify whether the term 'notification' is intentionally connecting this reporting with the notification process of changes in the IRB Rating.

If this is the case, further operational guidance on how to take onboard EBA in the process for communicating changes in the IRB Rating Systems would be needed.

In fact, we believe that the RTS is not precise enough as it is difficult to understand what is expected from credit institutions.

For example, in relation to reporting referred to in RTS Article 3, we note that in the CRR3 COREP consultation there is no detailed guidance how to report these 'other off-balance sheet items' (Template C07.00 is the only form where there are different buckets of SA-CCFs (0, 10, 20, 40, 50, 100, other) under which exposures can be reported).

However, there is no opportunity to explain the bank's rationale on why other off-balance sheet items are assigned to the specific bucket. The recent EBA's consultation on the amending ITS on reporting (closed last March 14) did not provide room for including this type of information within the proposed templates. Therefore, it would be appropriate for such a new consultation to be made once this RTS on OBS and UCCs is closed, to clarify the scope of 'other off-balance sheet items". We suggest that each bank reports its 'other' off-balance sheet items to its competent authority on a yearly basis together with a rationale why this product is assigned to this bucket and the competent authority reports all those type of 'other' off-balance sheet items to the EBA. Once a year, the EBA publishes the assignment of all 'other' off-balance sheet items reported to them with their view for the right assignment.

Question 9. *For credit institutions:*

What is the materiality in your institution of the off-balance sheet items that would fall under the categories "Other off-balance sheet items carrying similar risk and as communicated to EBA" listed in each bucket of Annex I?

Do you identify any specific item you may hold off-balance sheet that is currently classified as "Other off-balance sheet items carrying similar risk and as communicated to EBA" and that may experience a change in bucket allocation based on the criteria listed in Article 1 of these RTS? What would be the related change in the associated percentage as per article 111(2)?

- **Contingent liability/chargeback positions in acquiring business**

We appreciate that the EBA does not consider chargeback risk as a full risk item, but we disagree with classifying it as an example for bucket 2 in Annex I of the CRR. As this is a highly disproportionate overestimation of the actual likelihood of such losses, we would therefore propose the application of a 10% CCF for chargeback risk, as a better reflection of the actual risk, instead.

The following points underpin the classification as an item for bucket 5 in Annex I:

1. The realisation of a loss due to a chargeback event will only occur if:

    a. a valid chargeback claim against the merchant is initiated (there are a series of specific conditions that need to be satisfied for a customer of a merchant to raise a valid chargeback), for example due to fraudulent behaviour - refunds from general cancellation rights or refunds under a warranty claim etc. do not generally create an exposure for the acquiring bank; and

b. a merchant insolvency event has occurred, and the merchant does not make good its obligation;
c. the product/service is not provided by another party e.g. an administrator/an entity that acquired the merchant's business; and
d. there are no, or insufficient, cash reserves held back by the acquiring bank from the merchant to offset the chargeback claims.

2. The actual observed chargeback rates in the industry are historically very low, significantly below 0.6 % overall. Chargeback rates vary per industry and are different for in person versus online sales and for some industries, chargeback rates can be less than 0.2 %. A detailed analysis of chargebacks across merchant industries is performed by the respective card schemes on an ongoing basis. Furthermore, acquiring banks routinely monitor merchants and their chargeback ratios and excessive chargebacks (max. 1 % resp. max. 1.5 %) can lead to the termination of a merchant's account and thereby limiting the acquirer's exposure to the merchant. Lastly, it's not only in the interest of all involved parties to always strive for the highest security standards but also foreseen by respective payment regulations like PSD 2 and PSD 3 etc. hence leading to lower fraud cases.

3. Fraudulent behaviour is already covered by the CRR's capital requirements for operational risk. An unjustifiably high CCF for chargeback risk would lead to punitive double counting of this risk, even if it's related to fraud occurring in the sphere of the merchant and not directly involving the bank. If CRR-regulated banks are card acquirers, they also have to fulfil the respective AFC including fraud regulations. This also leads to exclusion of those industries with high chargeback risks.

4. Also to highlight is the major difference in capital treatment of chargeback risk that banks (i.e. CRR institutions) are facing compared to non-bank acquirers (i.e. payment institutions and e-money institutions – PI/EMI). The majority of acquiring service providers are registered as PI/EMI and regulated under the supervisory regime of the Payment Services Directive (PSD). Although a certain capital requirement is prescribed for those non-bank acquirers under PSD, the amount of capital is much smaller than what it would be even when applying only a of 10 % CCF. This leads to a significant business disadvantage for banks in the acquiring business, to increased costs for merchants and (Mostly consumer) cardholders. It is unlikely that it is the intention of European legislators to assess the underlying (chargeback) risk differently based on the authorisation of the institution providing the service (banks vs PI/EMI).

   In fact, the different capital treatment creates an unlevel-playing field between banks and non-banks offering acquiring services which, in the long-run, will not only disable banks from offering acquiring services for cards but will also impact their potential role as an acquirer for the digital euro, which is also intended to be introduced with a chargeback approach.

5. Lastly, BaFin in April 2022 published an explanatory statement relating to chargeback risk for credit card payments and its capital treatment under CRR [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Auslegungsentscheidung/EBA_QA/eba_CRR_52_22_011_kreditrisiko.html].

   BaFin issued this explanatory statement as the previously published EBA Q&A 2016_2916 left the applicable CCF for chargeback risk mainly open. Out of the four possible risk items under CRR 2 and considering the 'very low chargeback ratios compared to transaction volumes' BaFin decided that treating chargeback risk as "medium/low risk item" with 20 % CCF would be adequate. As CRR 3 now offers five buckets and that the lowest bucket does not have a CCF of 0 % anymore, applying bucket 5 of Annex 1 of CRR 3 would not contradict the argumentation of this BaFin explanatory note.

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