The CRR large exposures regime aims to prevent a bank from developing exposures to a single counterparty or connected counterparties which are so significant that they may threaten the solvency of the institution. A large exposures regime has existed in the Basel framework for some time, but the Basel Committee made amendments to it in a number of important respects in April 2014.

The CRR 2 proposal includes measures to implement this revised framework into EU law. As with the rest of the CRR 2 package we expect these proposals to come into force no earlier than 2019.

This note summarises the large exposure proposals in CRR 2, looks ahead to the next stage of the EU legislative process and sets out what firms should be doing now.
Summary of key proposals

Large exposures limit of 25% with enhanced requirements for global systemically important institutions (G-SIBs)

Any exposure to a counterparty or group of connected counterparties which is equal to or exceeds 10% of the firm’s Tier 1 capital constitutes a large exposure.

The CRR 2 proposals carry forward the 25% large exposure limit under CRR. But recognising the risk of contagion between G-SIBs the large exposure limit between them has been tightened to 15%.

Tightening the definition of capital

In line with the amended Basel framework, the CRR 2 proposals tighten the definition of capital used to calculate the large exposure limit. Going forward firms will have to calculate large exposures against Tier 1 capital, excluding Tier 2 capital.

Use of standardised approach for credit risk (SA-CCR) for calculating exposures with counterparty credit risk

In line with the revised Basel framework the CRR 2 proposals introduce a requirement that exposures which give rise to counterparty credit risk (such as OTC derivative transactions) should be calculated using the SA-CCR.

Exemptions from the large exposures measure

The current CRR includes a number of exemptions from the large exposure measure. The CRR 2 proposal makes some amendments to these and adds some limitations to their use. But the EC was not able to obtain sufficient quantitative data to assess the impact of removing or making permanent these exemptions. So it tasked the EBA with reporting on their use going forward, within one year of CRR 2 coming into force. This report will cover the materiality of the use of these exemptions and could potentially result in reporting requirements for firms.

Reporting requirements

The current CRR includes a number of reporting requirements relating to large exposures. The CRR 2 proposals make some amendments to these obligations. Under the proposals smaller institutions have to report on an annual basis, all other firms must report bi-annually or more often.

Firms are also required to report their top ten exposures to “shadow banks”. The EBA has been mandated to define which counterparties are shadow banks. This requirement will replace the current requirement for firms to report on exposures to ‘unregulated financial sector entities’ meaning the counterparties captured by this reporting requirement may change.

Potential Brexit implications

Under the current CRR, financial counterparties are only deemed to be institutions for the purposes of the large exposure measure if they are authorised in a jurisdiction that applies prudential supervisory and regulatory requirements equivalent to those applied in the EU.

The CRR 2 proposal introduces a new power for the EC to adopt a decision on this equivalence. IF the EC determined that the UK’s regime was not equivalent post-Brexit, then UK banks would not be classed as institutions for the purposes of the large exposures regime. In that case, exposures to UK banks resulting from payment services, clearing and settlement and correspondent banking, intra-day exposures from EU banks would be included in the large exposures calculations of EU banks, but exposures between EU banks as a result of these activities would not.

Looking ahead

The EC’s proposals will now be submitted to the Council and EP which will attempt to form a common position and then enter trilogue negotiations. Whilst the large exposures provisions are not amongst the most controversial in the CRD 5/CRR 2 package they may be subject to change.
**What do I need to do now?**

- The new large exposures regime represents both a tightening in prudential standards and a change in reporting requirements. Firms, and G-SIBs in particular, will need to re-examine their exposures to ensure they are able to comply with the new requirements. They should also begin to assess whether they have the systems capability to meet the amended reporting requirements.

- Firms will also need to consider how the new requirements will interact with other new and existing prudential standards such as the risk based capital framework.

- Our teams can help you make sure your business keeps track of the latest developments on CRD 5/CRR 2, as well as providing expert advice on the proposals for an amended large exposures regime.

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