EBA/CP/2020/13

22 July 2020

Consultation Paper

Draft Guidelines

specifying the conditions for the application of the alternative treatment of institutions' exposures related to "tri-party repurchase agreements" set out in Article 403(3) of Regulation (EU) 575/2013 for large exposures purposes

Contents

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 22 October 2020. 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 (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

As part of the "Risk Reduction Measures Package" adopted by European legislators in May 2019, Regulation (EU) 2019/876 has amended Part Four on Large Exposures of Regulation (EU) No 575/2013 (CRR).

Pursuant to Article 403(3) of the CRR and in the context of the mandatory substitution approach set forth in Article 403(1) of the CRR, an institution may replace the total amount of its exposures to a collateral issuer due to tri-party repurchase agreements facilitated by a tri-party agent, using as an alternative treatment the full amount of the limits that the institution has instructed the tri-party agent to apply to the securities issued by that collateral issuer. The amount of such a limit must be added to any other exposures to the same collateral issuer (direct loans, participations, etc.) with the overall amount and including exposures to a relevant group of connected clients, if available) complying with the large exposure limits. Irrespective of the use of this treatment, institutions remain responsible for monitoring their exposures and complying at all times with the large exposure limits.

To be able to conduct the aforementioned replacement, institutions must observe certain conditions. The EBA is mandated, under Article 403(4) of the CRR, to issue guidelines specifying those conditions, including the frequency for determining, monitoring and revising the full amount of the limits instructed by the institution to the tri-party agent.

In particular, the guidelines recommend a set of elements that an institution and a tri-party agent should include in their service agreement for the use of the alternative treatment. The guidelines establish a set of safeguards that the tri-party agent has to put in place and for which the institution needs to verify the appropriateness for the use of the alternative treatment. Furthermore, the guidelines specify how institutions should determine the limits to be applied by a tri-party agent with regard to the securities of a collateral issuer, as well as the general framework under which such limits can be revised.

Finally, the guidelines include a non-exhaustive list of circumstances that could lead the competent authority to raise material concerns and that would prevent the use of the alternative treatment by institutions. A procedure for dealing with those material concerns is also specified.

Next steps

The guidelines will be translated into the official EU languages and published on the EBA website. The deadline for competent authorities to report whether they comply with the guidelines will be two months after the publication of the translations. The guidelines will apply from June 2021.

3. Background and rationale

General considerations on tri-party repurchase transactions and tri-party agents

1. The market of repurchase transactions is a major source of short-term funding for institutions. A repurchase transaction is a financial transaction in which one party (collateral giver/provider and cash taker) sells an asset to another party (collateral receiver and cash provider) with a contractual engagement to repurchase the asset at a pre-specified later date. These transactions are often perceived to be secured lending transactions between the counterparties. Investors/lenders provide cash to a borrower, with the loan secured by the collateral of the borrower. By agreement between the two parties, the borrower buys the collateral back shortly afterwards, usually the following day, at a slightly higher price. The investor/lender charges an interest rate called the "repo rate". When a third party is involved to take over the administrative tasks involved in the collateral management (collateral selection, payments and deliveries, custody of collateral securities, collateral management and other operations during the life of the transaction), the transaction is referred to as a tri-party repurchase transaction or "tri-party transaction".

2. The third party responsible for collateral management in a tri-party transaction, also known as "tri-party agent", can be a custodian bank or a national (CSD) or international central securities depository (ICSD). Indeed, among the non-banking type ancillary services that a CSD can perform according to Regulation (EU) No 909/2014, is that of providing collateral management as agent for participants in a securities settlement system, as well as the provision of general collateral management services as agent.[1]

3. Tri-party agents serve as collateral managers whose main aim is to alleviate the administrative burden related to the transactions, but do not act as intermediaries or counterparties and are not exposed to the risks created by these transactions. The two parties to the repurchase transaction must operate transactions under a bilateral contractual agreement anyway.

4. Once the parties have agreed to a transaction, they must independently notify the tri-party agent, who will match both sets of instructions and process the transaction. The tri-party agent normally selects, from the seller's securities account, sufficient collateral that satisfies pre-agreed credit and liquidity criteria, concentration limits as well as any other transaction preferences agreed by the parties. The tri-party agent then performs tasks such as the regular revaluation of the collateral, variation margining and income payments on the collateral. The tri-party agent can also substitute any collateral that ceases to conform to the quality criteria of the buyer.

[1] Section B of the Annex of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

Legal mandate

5. As of 28 June 2021, and in accordance with Article 403(1) of Regulation (EU) No 575/2013 (CRR), as amended by Regulation (EU) 2019/876 [2] the substitution approach will be mandatory. Accordingly, the portion of the exposure to a client which is guaranteed by a third party or secured by collateral issued by a third party should be counted towards the guarantor or third party collateral issuer under the condition that the unsecured exposure to the guarantor or the collateralised portion of the exposure would be assigned a risk weight that is equal to or lower than the risk weight of the unsecured exposure to the client under Chapter 2 of Title II of Part Three of the CRR.

6. In particular, with regard to collateralised exposures, Article 403(3) of the CRR states that an institution may replace the total amount of its exposures to a collateral issuer due to a tri-party repurchase agreement (tri-party repo) facilitated by a tri-party agent with the full amount of the limits that the institution has instructed the tri-party agent to apply to the securities issued by that collateral issuer. To be able to conduct such replacement, three conditions must be met, namely:

    i. The institution must verify that the tri-party agent has in place appropriate safeguards to prevent breaches of the limits instructed by the institution (Article 403(3)(c) of the CRR);

    ii. The competent authority has not expressed to the institution any material concern (Article 403(3)(d) of the CRR); and

    iii. The sum of the amount of the limit instructed by the institution and any other exposures of the institution to the collateral issuer does not exceed the limit set out in Article 395(1) CRR (Article 403(3)(e) of the CRR).

7. The EBA is mandated under Article 403(4) of the CRR to issue guidelines specifying those three conditions, including the conditions and frequency for determining, monitoring and revising the limits that the institution instructed the tri-party agent. The EBA shall publish such guidelines by 31 December 2019.[3]

Large exposure limits under the mandatory substitution approach

8. Where an institution applies the mandatory substitution approach under Article 403(1) CRR, it remains subject to the large exposure limits as set out in Article 395(1) CRR. Such limits must be complied with at all times (Article 395(3) CRR). However, for some types of securities financing

[2] Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (Text with EEA relevance) OJ L 150, 7.6.2019, p. 1–225.

[3] However, the EBA published on 21 November 2019 a roadmap on the risk reduction package with a planned timetable to deliver the regulatory deliverables according to the mandates given by the CRR 2 to the EBA. According to the roadmap, these guidelines should be delivered by December 2020 (https://eba.europa.eu/eba-publishes-its-roadmap-risk-reduction-measures-package).

transactions, specifically tri-party repos, an institution may not have control over the collateral pool in real time, and thus may, for a certain period of time, exceed the large exposure limits. This could especially happen when an institution already has a substantial exposure to a collateral issuer included in the collateral pool managed by the tri-party agent.

9. In order to ensure compliance with the large exposure limits, yet to preserve the mandatory substitution approach and at the same time allow for certain flexibility in monitoring the said limits, institutions might replace the total amount of the institution's exposure to a collateral issuer due to tri-party repos facilitated by a tri-party agent with the full amount of the limits that the institution has instructed the tri-party agent to apply to the securities issued by that collateral issuer ('alternative treatment'). Thus, instead of continuously monitoring and calculating the actual total exposure to the collateral issuer in tri-party repos, institutions may instruct the tri-party agent upfront to apply certain limits on an on-going basis on exposures to that collateral issuer. The amount of that limit must be added to any other exposures to the same collateral issuer (direct loans, participations, etc.) and subject them to the large exposure limits.

10. The collateral limits specified at the outset of the tri-party repo should be set in a way that would not lead to a breach of the large exposure limits. That requires that the institution applying the alternative treatment has to verify that the tri-party agent has in place appropriate safeguards to prevent the limit instructed by the institution from being exceeded. If this and other conditions, as set out in Article 403(3) of the CRR, are met, institutions have the possibility of not having to continuously monitor their current exposures to collateral issuers under a particular agreement with the tri-party agent. In this regard, the alternative treatment can be deemed as more prudent, as not the actual exposure to a collateral issuer is counted towards the large exposure limit, but a communicated maximum amount that may or may not be drawn at any given moment together with any other exposures to that collateral issuer.

11. The use of the alternative treatment implies that any breach of the large exposure limit with respect to a certain collateral issuer could arise from an increase in exposures other than the exposures from tri-party repos. In such a situation, it should be up to the institution to decide how to rectify the breach in accordance with the applicable general procedures. For example, as soon as the amount of other exposures to a collateral issuer increases (or is likely to increase) an institution could change the limits instructed to the tri-party agent accordingly and in a timely manner; alternatively, it could manage its other exposures to that collateral issuer to prevent a revision of the instructed limits.

12. To inform the development of these guidelines, the EBA sought technical input from selected tri-party agents on actual market practices concerning the different areas that these guidelines specify as per the mandate in Article 403(4) of the CRR.

The condition that the tri-party agent has in place appropriate safeguards to prevent breaches to the limits instructed by the institution

13. The relationship with a tri-party agent is normally reflected in a bilateral contractual agreement. It is therefore necessary that both parties set out in their agreement the safeguards that the tri-party agent should put in place to ensure compliance with the instructed limits. These safeguards should be prudent and rely, to the extent possible, on existing arrangements with a tri-party agent such as concentration limits.

14. Since these safeguards are intended to support the management of risks related to the potential breach of limits instructed by the institution, institutions need to take into account the regulatory framework applicable to institutions in general as well as to tri-party agents. In particular, and for the reasons explained in the subsequent paragraphs, where an institution instructs a tri-party agent to manage collateral on its behalf, it needs to give consideration as to whether this arrangement falls under the definition of "outsourcing" as per the EBA Guidelines on outsourcing arrangements[4] and, if so, whether it is a critical or important outsourcing arrangement. On the other side, tri-party agents consist mostly of custodian banks as well as international and/or national central securities depositories (CSD). CSD are subject to regulatory and supervisory prudential requirements and are required to have robust governance arrangements, which should reduce the level of operational risks related to their involvement.

15. In general, as part of the overall internal control framework, institutions should have a holistic institution-wide risk management framework extending across all business lines and internal units. Under that framework, institutions should identify and manage all their risks, including risks caused by arrangements with third parties including with tri-party agents. The risk management framework should also enable institutions to make well-informed decisions on risk-taking and ensure that risk management measures are appropriately implemented.

16. Institutions on a risk-based approach should identify, assess, monitor and manage all risks resulting from arrangements with third parties to which they are or might be exposed, regardless of whether or not those arrangements are outsourcing arrangements. The risks, in particular the operational risks, of all arrangements with third parties, should be assessed.[5] Institutions should ensure that they comply with all the requirements under CRD/CRR, including in their arrangements with third parties.

EBA Guidelines on outsourcing arrangements

17. The EBA Guidelines on outsourcing arrangements set out how Articles 74 and 109 of Directive 2013/36/EU (CRD) pertaining to robust governance arrangements are to be applied with regard to outsourcing functions. Article 74 of Directive 2013/36/EU (CRD) requires that institutions have in

[4] See Final Report on EBA Guidelines on outsourcing arrangements. EBA/GL/2019/02. https://eba.europa.eu/sites/default/documents/files/documents/10180/2551996/38c80601-f5d7-4855-8ba3-702423665479/EBA%20revised%20Guidelines%20on%20outsourcing%20arrangements.pdf

[5] See section 12.2 of the EBA Guidelines on outsourcing arrangements, applicable to all third parties and not only under outsourcing.

place robust governance arrangements.[6] Therefore, these guidelines should be read in conjunction with, but without prejudice to, the EBA Guidelines on outsourcing arrangements. When entering into a tri-party repo with a tri-party agent, an institution should assess whether such arrangement falls under the definition of outsourcing as defined in the EBA Guidelines on outsourcing arrangements. In any case, institutions are required to manage all their risks, including the operational risks related to the involvement of tri-party agents.

18. In order to determine whether an arrangement with a third party falls under the definition of outsourcing, institutions should assess such arrangement, giving consideration as to whether the function (or a part thereof) that is outsourced to a service provider is performed on a recurrent or an ongoing basis by the service provider and whether this function (or part thereof) would normally fall within the scope of functions that would or could realistically be performed by institutions, even if the institution has not performed this function in the past itself.[7] This is without prejudice of paragraph 28 of the EBA Guidelines on outsourcing arrangements that provide examples of functions that institutions, as a general principle, should not consider as outsourcing.

19. Notwithstanding that assessment, institutions should have an appropriate risk management framework to manage all their risks, including risks stemming from contracts with third parties, in accordance with Article 74 of the CRD and the EBA Guidelines on internal governance[8].

The regulation of central securities depositories (CSD) and custodian banks

20. Regulation (EU) No 909/2014 on improving securities settlement in the EU and on central securities depositories, among other things, introduces strict organisational, conduct of business and prudential requirements for CSD and sets out increased prudential and supervisory requirements.[9]

21. The Regulation requires that a CSD shall have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate remuneration policies and internal control mechanisms, including sound administrative and accounting procedures.[10] Furthermore, a CSD shall have robust management and control systems as well as IT tools in order to identify, monitor and manage general business risks, including losses from poor execution of business strategy, cash flows and operating expenses.[11] In terms of operational risk, a CSD shall identify sources of operational risk, both

[6] 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 Text with EEA relevance. OJ L 176, 27.6.2013, p. 338–436.

[7] See section 3 of the EBA Guidelines on outsourcing arrangements.

[8] Final Report on Guidelines on Internal Governance under Directive 2013/36/EU (EBA/GL/2017/11) of 26 September 2017.

[9] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

[10] Article 26 of Regulation (EU) No 909/2014.

[11] Article 44 of Regulation (EU) No 909/2014.

internal and external, and minimise their impact through the deployment of appropriate IT tools, controls and procedures, including for all the securities settlement systems it operates.[12]

The condition that the competent authority has not expressed to the institution any material concerns

22. To support the implementation of the alternative treatment, the guidelines provide guidance as to whether a concern expressed by a competent authority to an institution should be considered "material", in which case the institution should not make use of the alternative treatment; or, when it is already using it, address it within the timeframe given by the competent authority before it can resume again its use. A material concern could primarily arise from the institution itself, from the tri-party agent or from the provisions of the service agreement. The guidelines do not provide an exhaustive list of such material concerns but rather a series of elements where this condition could be met.

23. To determine whether a concern is "material", competent authorities should take into account the overall exposures reported by an institution to collateral issuers. A competent authority should take into account the management procedures and internal controls that the institution has in place to identify, manage, monitor, report and record all large exposures and subsequent changes to them. The competent authority should also satisfy itself that the provisions included in the service agreement with the tri-party agent comply with applicable laws and regulatory requirements, including these guidelines. In this context, the safeguards implemented by the tri-party agent to observe the instructed limits should be taken into account. A material concern can arise, too, where the tri-party agent is a regulated entity and during the use of the alternative treatment, its authorisation is withdrawn by the authority responsible for its supervision. Finally, the competent authority can also have material concerns with regard to the practical implementation of the conditions and frequency for monitoring and revising the instructed limits.

24. Prior to using the alternative treatment, institutions should notify the competent authority of their intention to use the alternative treatment and submit a notification. The notification should be accompanied by a declaration approved by the management body of the institution that the use of the alternative treatment is in line with the requirements of these guidelines. Further to the receipt of that notification, the competent authority should inform the institution only in the case that it has any material concerns on the use of the alternative treatment. If there are no material concerns, the competent authority should not communicate with the institution.

25. A competent authority can express material concerns at any time during the use of the alternative treatment. In that case, the institution has to cease the use of the alternative treatment and take the appropriate measures to remedy them within the timeframe given by the competent authority if it wants to continue using it.

[12] Article 45 of Regulation (EU) No 909/2014.

The condition that the sum of the amount of the limit instructed by the institution to the tri-party agent and any other exposures of the institution to the collateral issuer does not exceed the limit set out in Article 395(1) of the CRR

26. Institutions are under the obligation to observe the large exposure limits set out in Article 395(1) of the CRR at all times, regardless of whether or not they make use of the alternative treatment under Article 403(3) of the CRR.

27. An institution should ensure that the sum of all its exposures to a collateral issuer and its group of connected clients, if available, plus the limits instructed to the tri-party agent as regards the securities issued by that collateral issuer, after taking into account the effect of credit risk mitigation, do not exceed the limits set out in Article 395(1) of the CRR. For these purposes, an institution should integrate the instructed limits in its systems and procedures so that it has real-time knowledge of its exposures to a collateral issuer and its group of connected clients, if available, including the instructed limits to a tri-party agent in respect of the securities issued by the same collateral issuer.

28. Furthermore, to prevent that an institution is constrained by the instructed limits to manage its overall exposures to a given collateral issuer and its group of connected clients, if available, yet that the tri-party repo is not devoid of its economic and operational advantages to manage collateral, the instructed limits should be subject to revisions. The collateral management service agreement with a tri-party agent should set out the conditions for the introduction of changes to the instructed limits.

29. Where a limit managed by a tri-party agent has been breached, the institution should be informed immediately. The tri-party agent should have remedied it and should inform the institution of the time taken to remedy it. Furthermore, the institution should ensure that its management body is informed of any breaches of the instructed limits and their likely impact on the large exposure limits. It is the duty of an institution to ensure that the instructed limits are revised immediately to deal with any breaches.

Conditions and frequency for determining, monitoring and revising the limits instructed by the institution to the tri-party agent

30. While the guidelines leave ample room to the counterparties to negotiate the conditions of the contract, they however provide some elements to determine such conditions for the use of the alternative treatment. In particular, the guidelines specify the conditions that an institution should take into account when setting the instructed limits to the tri-party agent; the form and frequency of the monitoring of the instructed limits; and the conditions for revising the instructed limits and frequency of their revision.

31. Such conditions respect the principle of proportionality, i.e. they should not render the management of collateral by a tri-party agent void of its economic and operational advantages. They also rely, to the possible extent, on current market practices and at the same time represent a prudent approach to the management of large exposures.

32. In terms of determining the instructed limits, the guidelines provide the elements that should inform such determination. The institution should apply a margin of conservatism such that it would facilitate the management of its exposures within the limits of Article 395(1) of the CRR. The instructed limits should be expressed as an absolute amount or a percentage value of a specific type of security in the portfolio.

33. Equally, an institution should consider its overall exposures to a collateral issuer and its group of connected clients, if available, and the risk of breaching the large exposure limits with a view to revising the instructed limits. Such revisions should be possible during the lifetime of the agreement with the tri-party agent and should be implemented in a timely manner in order to prevent a breach of the limits.

34. Finally, the guidelines rely on current monitoring systems to integrate the alternative treatment. Institutions should receive, at least on a weekly basis, information from the tri-party agent about the amount and composition of the received collateral. This information should help institutions to decide whether revisions are necessary so as to ensure compliance with the large exposure limits.

Rationale for the Guidelines

35. The purpose of these guidelines is to provide guiding principles on the use of the alternative treatment referred to in Article 403(3) of the CRR for those instances where an institution decides to make use of such possibility. While current market practices have constituted a major starting point for the development of these guidelines, some deviations are necessary to ensure that the use of the alternative treatment is consistent across institutions in the Union and is implemented in a sufficiently prudent manner.

36. The guidelines were developed with the following objectives:

    i. Ensure a prudent and harmonised application of Article 403(3) of the CRR while keeping the approach simple;

    ii. Ensure a level playing field among institutions in the Union; and

    iii. Provide guidance to competent authorities in their assessment of compliance.

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4. Guidelines

Draft Guidelines

specifying the conditions for the application of the alternative treatment of institutions' exposures related to "tri-party repurchase agreements" set out in Article 403(3) of Regulation (EU) 575/2013 for large exposures purposes

1. Compliance and reporting obligations

1.1. Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010.[13] In accordance with Article 16(3) of the Regulation, competent authorities and financial institutions must make every effort to comply with the guidelines.

2. Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. The EBA therefore expects all competent authorities and financial institutions to whom guidelines are addressed to comply with guidelines. Competent authorities to whom guidelines apply should comply by incorporating them into their supervisory practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

1.2. Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by ([dd.mm.yyyy]). In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to compliance@eba.europa.eu with the reference 'EBA/GL/202X/XX'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.

4. Notifications will be published on the EBA website, in line with Article 16(3) of Regulation (EU) No 1093/2010.

2. Subject matter, scope and definitions

Subject matter

[13] 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).

5. These guidelines specify, in accordance with the mandate set out in Article 403(4) of Regulation (EU) No 575/2013, the conditions that an institution should comply with where it decides to make use of the alternative treatment provided under Article 403(3) of that Regulation with regard to tri-party repurchase agreements facilitated by a tri-party agent, including the conditions and frequency for determining, monitoring and revising the limits referred to in point (b) of Article 403(3) of Regulation (EU) No 575/2013, for the purposes of applying the substitution approach provided for in point (b) of Article 403(1) of that Regulation.

Scope of application

6. These guidelines apply in relation to institutions' exposures to collateral issuers due to tri-party repurchase agreements (tri-party repos) facilitated by a tri-party agent.

Addressees

7. These guidelines are addressed to competent authorities as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation (EU) No 1093/2010.

Definitions

8. Unless otherwise specified, the terms used and defined in Regulation (EU) No 575/2013 and Directive 2013/36/EU have the same meaning in the guidelines.

Tri-party repurchase transaction (tri-party transaction)	means a repurchase transaction where the cash/collateral is received in deposit and managed by a tri-party agent.
Tri-party repurchase agreement (tri-party repo)	means a repurchase agreement whereby the counterparties appoint a tri-party agent to act as their intermediary and facilitate services during the execution of a tri-party transaction.
Collateral management service agreement (*service agreement*)	means the agreement between an institution and a tri-party agent for the management of collateral provided to the institution in the context of the execution of a tri-party transaction.
Tri-party agent	means a third party that executes payments and/or delivery of securities, provides safekeeping and administration services of securities including collateral selection, custodianship and/or cash/collateral management and performs other operations for the account of the counterparties to a tri-party transaction.

Collateral issuer	means the third party issuing the security that is received by the institution as collateral for a tri-party transaction as referred to in point (b) of Article 403(1) and points (a) and (b) of Article 403(3) of Regulation (EU) No 575/2013.
Alternative treatment	means the approach whereby an institution replaces the total amount of the institution's exposures to a collateral issuer due to a tri-party repo facilitated by a tri-party agent with the full amount of the limits that that institution has instructed the tri-party agent to apply to the securities issued by the same collateral issuer in accordance with Article 403(3) of Regulation (EU) No 575/2013.
Instructed limits	mean the limits communicated by an institution to a tri-party agent, applicable to the securities issued by the collateral issuer as referred to in point (b) of Article 403(3) of Regulation (EU) No 575/2013.

Explanatory box and question for consultation

Certain terms like 'collateral management service agreement', as defined and used in the guidelines might deviate from terms and expressions used e.g. by a tri-party agent.

Question 1: Are the definitions and their use throughout the guidelines clear?

3. Implementation

3.1 Date of application

9. These guidelines apply from 28 June 2021.

4. Conditions for the application of the alternative treatment

10. Institutions should rely on a third-party agent for the use of the alternative treatment only where they have carried out appropriate due diligence to verify that the tri-party agent complies with the conditions specified in these guidelines.

4.1 Governance arrangements

11. For the purposes of these guidelines, institutions should ensure, in accordance with the EBA Guidelines on Internal Governance, that:

    a) the use of the alternative treatment is adequately documented in its policies and procedures; and

    b) their management body oversees and monitors the implementation of the alternative treatment.

4.2 Verification of the establishment of appropriate safeguards by the tri-party agent to prevent breaches of the limits instructed by the institution to apply to the securities issued by the collateral issuer

4.2.1 Minimum elements to be included in the service agreement

12. For the purposes of verifying that the tri-party agent has put in place appropriate safeguards to prevent breaches of the instructed limits and without prejudice to other provisions in these guidelines, institutions should ensure that the service agreement sets out at least the following elements:

    a. a clear description of the services provided by the tri-party agent with regard to collateral management including securities delivery;

    b. the limits set out by the institution and applicable to a portfolio of securities in respect of a given collateral issuer as well as the conditions for their revision and the frequency of revision;

    c. the safeguards that the tri-party agent has put in place to ensure compliance with the instructed limits;

    d. the tri-party agent's monitoring systems, including the communication by the tri-party agent of any development that may have a material impact on its ability to effectively carry out its functions in line with the service agreement and, where applicable, in compliance with the applicable laws and regulatory requirements;

e. the tri-party agent's obligation to submit reports to the institution, at least on a weekly basis, on the amount and composition of the collateral received and/or managed by the tri-party agent for the account of the institution;

f. the tri party agent's obligation to report immediately to the institution when a breach of the instructed limits has occurred;

g. the right of the institution or a legitimate third party (inter alia the statutory auditor, the competent authority or third parties appointed by them) to verify compliance with the safeguards referred to in point c.

Explanatory box and questions for consultation

This section is intended to set the general framework for the use of the alternative treatment. It provides a list of elements that, with regard to the use of the alternative treatment, the service agreement should at least contain.

Question 2: Do you think that this general framework is appropriate? Are there other elements that should be included to make the service agreement more comprehensive?

4.2.2 Content of the safeguards to be put in place by a tri-party agent to ensure compliance with the limits instructed by the institution

13. The safeguards referred to in point c) of paragraph 12 should include the following:

a. Tri-party collateral management is only performed in accordance with the duly signed service agreement;

b. Tri-party agents have set up a control environment which ensures, for each communication on instructed limits, that these limits are duly authorised by the institution, and are entered and processed accurately, in due time and only once in their collateral management system;

c. Tri-party agents have set up a control environment that ensures that collateral is safeguarded, actively monitored and pricing values are duly recorded in a timely manner;

d. Tri-party agents have set up a control environment which ensures the detection, in a timely manner, of possible breach(es) of the instructed limits;

e. When allocating collateral securities to cover an exposure, the tri-party agent's systems ensure that their market value does not breach any of the instructed limits and/or exclusions. In case of an inadequate application of the revised limits instructed by the institution due to operational issues, the tri-party agent should notify the institution in due time;

f. Tri-party agents should be contractually required to comply with the instructed limits and to ensure that the eligibility profiles of collateral issuers and securities as referred to in section 4.3.1 can be verified on the basis of the information provided under the service agreement by the institution and the collateral provider.

14. Institutions should obtain, at least annually, an adequate level of assurance in the form of a written declaration that the tri-party agent complies with the safeguards put in place in accordance with the service agreement.

Explanatory box and questions for consultation

This section defines the safeguards that a tri-party agent should put in place and an institution should verify that they are appropriate for the use of the alternative treatment. Such safeguards should be reflected in the service agreement.

Question 3: Do you agree with the list of proposed safeguards? If no, please explain why and present possible alternatives.

Question 4: Do you see any practical reasons that would prevent the implementation of any of the safeguards? If yes, please explain.

4.3 Determination, revision and monitoring of the limits instructed by the institution to the tri-party agent to apply to the securities issued by the collateral issuer

4.3.1 Determination of the instructed limits

15. Institutions should determine specific limits to each collateral issuer and, if deemed necessary, to exclude certain collateral issuers in order not to breach the large exposure limits set out in Article 395(1) of Regulation (EU) No 575/2013.

16. Limits should be expressed as an absolute amount or percentage value of all securities or a specific type of security in the collateral issuer's portfolio.

17. With a view to determining the instructed limits, institutions should set up eligibility profiles based on lists of collateral issuers and on types of securities which the tri-party agent could use for the composition of a given collateral issuer's portfolio of securities. For these purposes, institutions should take into account possible connections between single collateral issuers or between single collateral issuers and clients of the whole portfolio that could lead to a group of connected clients according to Article 4(1)(39) of Regulation (EU) No 575/2013.

18. For the purposes of determining the instructed limit applicable to a portfolio of securities by a given collateral issuer, institutions should take into account the following:

a) their current exposures to the collateral issuer and its group of connected clients, if available;

b) their exposures to the collateral issuer and its group of connected clients, if available, during the previous calendar year;

c) their scheduled exposures to the collateral issuer and its group of connected clients, if available, for the forthcoming 6 to 12 months;

d) whether the institution has managed the securities issued by a collateral issuer via tri-party repos or a combination of tri-party repos and repo transactions entered into directly with a counterparty.

19. In addition to the elements mentioned in paragraphs 17 and 18, institutions should set limits by applying a margin of conservatism that would allow the institution to comply with the large exposure limits set out in Article 395(1) of Regulation (EU) No 575/2013 at all times.

Explanatory box and questions for consultation

This section does not provide for the application of any specific quantitative limits when determining the limit applicable to a portfolio of securities by a given collateral issuer, as this should be left to the contractual discretion of the counterparties with due respect to the conditions listed in this section.

Question 5: Do you consider that the criteria listed in this section, in particular in paragraph 18, provide a sufficient guidance for institutions to determine limits? Are there any other elements that would be useful to include?

Question 6: Is it clear to you how to apply a 'margin of conservatism' as set out in paragraph 19?

The EBA understands that it is current market practice to determine limits and revisions to the limits on the basis of an absolute amount or of a percentage value of a specific type of security in the portfolio.

Question 7: Do you think that applying the same criteria for the alternative treatment is a suitable method? Do you consider that there could be alternative ways?

4.3.2 Revision of the instructed limits and its frequency

20. Institutions should ensure that the service agreement includes the circumstances under which the instructed limits could be revised and the frequency of their revision.

21. In particular, institutions should be in the position to request the revision of the instructed limits based on the reports from the tri-party agent referred to in point e) of paragraph 12 or when they are informed of any breaches of the instructed limits by the tri-party agent.

22. In determining the circumstances referred to in paragraph 20, institutions should consider their overall exposures to a collateral issuer and its group of connected clients, if available, and the risk of breaching the large exposure limits set out in Article 395(1) of Regulation (EU) No 575/2013. Institutions should also take into account their ability, with due regard to their administrative and accounting procedures and internal control mechanisms, to manage in a timely manner any other exposures to a collateral issuer they may have so as to avoid a breach of the large exposure limits.

23. The revision of the instructed limits should take the form of a change of the absolute amount of the instructed limit or the percentage value of a specific type of securities in the portfolio of a collateral issuer. It may also take the form of the exclusion or inclusion of a type of securities in the portfolio of a collateral issuer.

24. The revision of the instructed limits should be possible during the lifetime of the service agreement and should be executed in a timely manner by the tri-party agent once the institution has informed it thereof.

Explanatory box and questions for consultation

The EBA understands that revisions to an agreement can take the form of either a bilateral agreement between the counterparties, or a unilateral right of the collateral receiver to do so, although in the latter case, this right is restricted to a certain type of entities.

Furthermore, the guidelines do not detail the specific circumstances under which the instructed limits should be revised. However, an important condition is that institutions should introduce revisions to the limits having in mind the observance of the large exposure limit towards a given collateral issuer and the risk that it could be breached.

Question 8: Do you agree with the general approach for the revision of the instructed limits? Is this approach appropriate in the context of general revisions of concentration limits and exclusions that currently govern the relationships with tri-party agents?

In terms of frequency, the guidelines require a dynamic revision during the lifetime of the service agreement and thus do not set specific timeframes or a mandatory revision after some time.

Question 9: Do you agree with the general approach regarding when the limits need to be revised?

4.3.3 Monitoring of the instructed limits and its frequency

25. Where institutions make use of the alternative treatment, they should verify that the systems that the tri-party agent has in place to monitor the collateral composition are adequate with regard to the accurate and timely management of the instructed limits.

26. In particular, institutions should verify that the tri-party agent's monitoring systems allow the tri-party agent to trigger movements within the portfolio of securities of a given collateral issuer to ensure compliance with the instructed limits.

27. Institutions should also verify that the tri-party agent manages the collateral revaluation, variation margining, income payments on the collaterals and possibly any necessary substitution of collateral in accordance with its tri-party obligations under the service agreement.

Explanatory box and questions for consultation

The EBA understands that tri-party agents normally trigger automatic revisions of the instructed limits when these are breached. The guidelines follow the same approach and require that institutions ensure that the systems in place by a tri-party agent trigger movements within the portfolio of securities of a collateral issuer to ensure compliance with the instructed limit. Furthermore, monitoring systems should allow the accurate and timely management of the instructed limits.

Question 10: Do you think that the guidelines represent an appropriate approach to the monitoring of the instructed limit and in general of the implementation of the alternative treatment?

Question 11: Do you think that tri-party agents have in place such controls that would facilitate the management of the instructed limits? Would you assess that the control mechanisms should be more precise and prescriptive?

4.4 Ensuring compliance with the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013

28. Institutions should ensure that the use of the alternative treatment does not lead to a breach of the large exposure limits set out in Article 395(1) of Regulation (EU) No 575/2013.

29. Where a breach of the instructed limits has occurred, the tri-party agent should inform the institution immediately of:

    a) the name of the collateral issuer in relation with which the breach has occurred;

    b) the ISIN or security code of the securities received as collateral;

    c) the market value of the collateral received;

    d) the date when the breach occurred;

    e) the remedial action adopted by the tri-party agent; and

f) the timeframe within which the breach has been or is expected to be remedied.

30. The institution's management body should be informed without undue delay of any breaches of the instructed limits to the securities by a collateral issuer and its likely impact on the compliance with the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013 to the same collateral issuer.

31. Without prejudice to the actions by the tri-party agent to remedy any breach of the instructed limits, institutions should also have in place appropriate action plans to deal with breaches of the instructed limits to ensure that the large exposure limit of Article 395(1) of Regulation (EU) No 575/2013 to a given collateral issuer is complied with at all times.

4.5 Communication with competent authorities

4.5.1 Notification of the intention to use the alternative treatment

32. Where an institution intends to make use of the alternative treatment with a tri-party agent, it should notify ex-ante the competent authority. The notification should at least comprise the following elements:

a. a confirmation of its intention to use the alternative treatment;

b. a description of the main elements of the service agreement;

c. the identification of the tri-party agent(s) that it intends to use;

d. a declaration approved by the management body of the institution that the use of the alternative treatment complies with the requirements of these guidelines.

33. The competent authority should have access to all the information deemed necessary to verify the institution's adequacy with the requirements of these guidelines. The competent authority should be able to request additional information where necessary.

34. Where an institution intends to terminate the agreement concluded with a tri-party agent, it should inform the competent authority as soon as possible.

4.5.2 Material concerns expressed by the competent authorities

35. A material concern on the use of the alternative treatment should be based at least on any of the following reasons:

Material concerns with regard to the institution

a) the use of the alternative treatment leads or is likely to lead to a breach of the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013;

b) the institution is not complying with its reporting requirements in accordance with Articles 394 and 430 of Regulation (EU) No 575/2013;

c) the alternative treatment is not integrated or is only partially integrated in the risk management framework of the institution;

d) relevant findings from on-site inspections, internal and external audits or other supervisory assessments provide evidence of insufficient internal procedures to manage and/or monitor the use of the alternative treatment in accordance with these guidelines.

Material concerns with regard to the service agreement

e) the provisions included in the service agreement do not ensure compliance with applicable laws and regulatory requirements, including these guidelines. In particular:

i. the provisions of the service agreement regarding the revision of the instructed limits would make it impossible for an institution to request the timely implementation of changes to prevent a breach of the large exposure limits of Article 395(1) of Regulation (EU) No 575/2013.

ii. the institution or a legitimate third party do not have the right to audit the services provided by the tri-party agent under the service agreement to verify that the tri-party agent has in place appropriate safeguards to prevent breaches of the limits instructed by the institution as referred to in point (b) of Article 403(3) of Regulation (EU) No 575/2013;

Material concerns with regard to the tri-party agent

f) the tri-party agent is a regulated entity and its authorisation is subsequently withdrawn by its competent authority;

g) there is evidence that the tri-party agent has not complied with the requirements for the timely introduction of revisions to the instructed limits in accordance with the terms of the service agreement, or it has not observed requests from the institution to exclude certain collaterals or collateral issuers; or its monitoring systems do not provide for an accurate and timely management of the instructed limits.

Explanatory box and questions for consultation

A competent authority can express a material concern both before the start of the use of the alternative treatment and during its lifetime. The guidelines provide a list of non-exhaustive material concerns that would lead to the prohibition of the use of the alternative treatment. However, there might be other reasons, not listed here, that could give rise to a material concern. Grounds for other material concerns could arise e.g. in the context of on-site supervision of the institution.

Question 12: Do you agree with the non-exhaustive list of material concerns?

Question 13: Are you aware of any other material concerns to be included in the guidelines?

4.5.3 Procedure for dealing with a material concern

36. Upon receipt of the notification set out in section 4.5.1, the competent authority should inform the institution within four weeks if it has any material concerns on the use of the alternative treatment, in which case it should state its reasons. If there are no material concerns, there does not need to be any further communication regarding that notification.

37. Institutions should not use the alternative treatment until the competent authority has satisfied itself that the institution has satisfactorily addressed any material concerns.

38. If an institution is already making use of the alternative treatment and subsequently the competent authority informs the institution that it has material concerns on its use, the institution should cease to use the alternative treatment and provide evidence to the competent authority to that effect.

39. The institution should only resume the use of the alternative treatment where, within the timeframe set by the competent authority, it has satisfactorily addressed the material concerns and provided evidence to the competent authority to that effect.

Questions for consultation

Question 14: Do you see a need for further clarification of the procedure dealing with a material concern?

Question 15: Please specify what overall impact the proposed procedure would have on expected practices.

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

Article 403(4) of Regulation (EU) No 575/2013 requires the EBA to issue by 31 December 2019 guidelines specifying the conditions for the application of the alternative treatment referred to in paragraph 3 of Article 403 of Regulation (EU) No 575/2013, including the conditions and frequency for determining, monitoring and revising the limits referred to in point (b) of that paragraph.

The present analysis provides the reader with an overview of the findings as regards problem identification, possible options to remove problems and their potential impacts. Given the nature and the scope of the guidelines, the analysis is high-level and qualitative in nature.

A. Problem identification and baseline scenario

The large exposure framework complements the risk-based capital standard (Basel II / III). Indeed, the minimum capital requirements (Pillar 1) of the Basel capital framework implicitly assume that a bank holds infinitely granular portfolios. As a backstop to risk-based capital requirements, the large exposure framework is designed so to limit the maximum possible loss a bank could incur if a single counter-party or group of connected counter-parties fail.

With the aim to obtain a comprehensive measure of the exposures toward a counterparty, beside direct on-balance exposures, also off-balance exposures and indirect exposures that can arise through financial instruments like derivatives must be included in the definition of exposures toward a single counterparty or group of connected counter-parties. However, credit risk mitigation (CRM) techniques can be used to reduce the level of the exposures.

In particular, if the substitution approach of the CRM is applied, Regulation (EU) No 575/2013 requires that the portion of the exposure to a client which is guaranteed by a third party or secured by collateral issued by a third party must be included in the definition of the exposures towards the guarantor or the third party collateral provider.

Pursuant to Article 395(3) of Regulation (EU) No 575/2013, institutions must comply with the large exposure limits at all times. This implies for institutions to have knowledge of collateral received on a continuous basis but in the case of certain types of securities financing transactions, specifically tri-party repurchase agreements, an institution may not have complete control over the collateral pool on a daily basis.

B. Policy objectives

In order to allow flexibility in monitoring the large exposure limits, an alternative treatment to apply the mandatory substitution approach to tri-party repos has been introduced in Article 403(3) of Regulation (EU) No 575/2013. It gives the possibility that institutions replace the total amount of

the institution's exposure to a collateral issuer due to tri-party repos facilitated by a tri-party agent with the full amount of the limits that the institution has instructed the tri-party agent to apply to the securities issued by a certain collateral issuer. Thus, instead of continuously monitoring and calculating the actual total exposure to a collateral issuer in tri-party repos, institutions may instruct the tri-party agent upfront to apply certain limits on exposures to that collateral issuer.

Article 403(4) of Regulation (EU) No 575/2013 requires the EBA to issue guidelines specifying the conditions for the application of such an alternative treatment. The objective of the guidelines is to set a common framework between Member States to harmonise the conditions and the limits needed for the application of the alternative treatment.

C. Cost-Benefit Analysis

Scope of the guidelines

The common framework presented in these guidelines ensures a harmonised identification and application of the conditions required for the application of the alternative treatment set out in Article 403(3) of Regulation (EU) No 575/2013.

It is deemed that without the indications provided by the guidelines, different interpretations across banks and countries could arise about the conditions and frequency for determining, monitoring and revising the limits used as proxy of exposures toward the collateral issuers.

It is worth noticing that the alternative treatment of Article 403(3) of Regulation (EU) No 575/2013 can is deemed as more conservative, as not the actual exposure to a collateral issuer is counted towards the large exposure limit, but a communicated maximum amount that may or may not be drawn at any given moment.

Breach of the large exposure limits

Under the alternative approach of Article 403(3) of Regulation (EU) No 575/2013 it would be possible that a breach of the large exposure limit with respect to a certain collateral issuer could arise from an increase in exposures other than the exposures from tri-party repurchase transactions. In such a situation, it is suggested by the guidelines that to prevent a breach, as soon as the amount of other exposures to a certain collateral issuer increases (or is likely to increase) an institution should change the limits communicated to the tri-party agent accordingly and in a timely manner.

It is worth mentioning that the guidelines also suggest to set the limits considering the current, past and scheduled exposure to a collateral issuer and its group of connected clients, if available, but also to include a margin of conservativism. The requirement about the inclusion of a margin of conservativism could help to reduce the risk of a breach and consequently reduce the possible burdensome activities needed to regularize the situation.

5.2 Overview of questions for consultation

- **Question 1**: Are the definitions and their use throughout the guidelines clear?
- **Question 2**: Do you think that this general framework is appropriate? Are there other elements that should be included to make the service agreement more comprehensive?
- **Question 3**: Do you agree with the list of proposed safeguards? If no, please explain why and present possible alternatives.
- **Question 4**: Do you see any practical reasons that would prevent the implementation of any of the safeguards? If yes, please explain.
- **Question 5**: Do you consider that the criteria listed in this section, in particular in paragraph 18, provide a sufficient guidance for institutions to determine limits? Are there any other elements that would be useful to include?
- **Question 6**: Is it clear to you how to apply a 'margin of conservatism' as set out in paragraph 19?
- **Question 7**: Do you think that applying the same criteria for the alternative treatment is a suitable method? Do you consider that there could be alternative ways?
- **Question 8**: Do you agree with the general approach for the revision of the instructed limits? Is this approach appropriate in the context of general revisions of concentration limits and exclusions that currently govern the relationships with tri-party agents?
- **Question 9**: Do you agree with the general approach regarding when the limits need to be revised?
- **Question 10**: Do you think that the guidelines represent an appropriate approach to the monitoring of the instructed limit and in general of the implementation of the alternative treatment?
- **Question 11**: Do you think that tri-party agents have in place such controls that would facilitate the management of the instructed limits? Would you assess that the control mechanisms should be more precise and prescriptive?
- **Question 12**: Do you agree with the non-exhaustive list of material concerns?
- **Question 13**: Are you aware of any other material concerns to be included in the guidelines?
- **Question 14**: Do you see a need for further clarification of the procedure dealing with a material concern?
- **Question 15**: Please specify what overall impact the proposed procedure would have on expected practices.