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Legal act	Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876 (CRR2)
Topic	Market risk
Article	350
Paragraph	-
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	not applicable
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Disclose name of institution / entity	No
Type of submitter	Competent authority
Subject matter	Treatment of CIUs in internal model for market risk – possible restrictions
Question	Is the use of internal models to compute own funds requirement for market risk of positions in CIUs restricted to either of the conditions referred to in paragraphs (1) and (2) of Article 350?
Background on the question	Following the structure of the CRR chapter 2 Art. 348 to 350 CRR are only applicable for trading book positions subject to position risk calculated using the standardised approach. There is only one reference to CIUs within the chapter for internal models (chapter 5 - namely Art. 364 (2) lit. a. CRR with regard to position risk). The old requirements on CIUs with respect to. the inclusion of CIUs into the internal model can be found in the DIRECTIVE 2006/49/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 June 2006 (CAD). Referring to CAD (position risk; Annex I, para. 53 to 55), only CIUs for which a look through could be performed (Annex I para 53 CAD) or CIUs which were replicated using an index (Annex I para 54 CAD) were allowed to be included into the internal model (both paragraphs had an explicit reference to the internal models), whereas CIUs for which both possibilities were not possible (Annex I para. 55 CAD) explicitly had to be included in the standardized approach for the

purpose of calculating own funds requirements. It should be noted that the requirements of Annex I para 53 CAD are similar to Art. 350 (1) CRR, the requirements of Annex I para 54 CAD are similar to Art. 350 (2) CRR and the requirements of Annex I para 55 CAD are similar to Art. 350 (3) CRR. According to our view there are the following possibilities to answer the question whether there are any restrictions whether CIUs can be included in an internal model for market risk or not: a) The treatment for CIUs with respect to. position risk did not change from CAD to CRR. Hence CIUs can only be included in the internal model if the requirements of Art. 350 (1) or Art. 350 (2) CRR are met, i.e. when a daily look-through is possible or, respectively, when the purpose of the CIU's mandate is to replicate an externally generated index or basket and the CIU's price returns meet the correlation criterion. If not, CIUs can only be included in the standardized approach. This treatment would fill the potential regulatory gap Art. 364 (2) lit. a CRR with respect to. general risk of CIUs in a conservative way. b) Same treatment than option a) – but CIUs can additionally be included in the internal models by an institution on a voluntarily basis. c) The fact that the references to the look through approach in connection with the possibility to include CIUs in an internal model for market risk or not had not been resumed in the CRR means that generally all CIUs can be included in the internal model without any restrictions. Hence the treatment changed from CAD to CRR. Please mind that this question is only about the eligibility of CIUs for internal models, not about how the CIUs are ultimately modelled. The point whether Art. 350 restricts the choice of the modelling approach is addressed in a different question.

EBA answer

According to Chapter 5 of Title IV of Part III of Regulation (EU) No 575/2013 (CRR), the use of internal models set out in Article 364(1) (Value-At-Risk (VaR) and Stressed Value-At-Risk (SVaR)) for positions in CIUs is not restricted to positions for which either of the conditions in Article 350(1) and Article 350(2) are fulfilled. However, those positions can be included in the internal models only where all other requirements for including positions in the internal model are met (e.g. requirements on risk-measurement set out in Article 367, requirements on modelling specific risk set out in Article 370).

The use of the internal models set out in Article 364(2)(b) (Incremental Risk Charge (IRC)) for positions in CIUs is restricted to positions for which either of the conditions in Article 350(1) and Article 350(2) are fulfilled. When those conditions are not met, institutions are to fulfil additional own funds requirements in accordance with Article 364(2)(a) of CRR.

Link

https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_4378

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