Chapter 5

Concentration risk

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5.7   Calculating K-CON

5.7.1   **R**   The *K-CON requirement* of a *MIFIDPRU investment firm* is equal to the sum of the *CON own funds requirement* for each *client* or *group of connected clients* for which the *EV* exceeds the *concentration risk soft limit*.

5.7.2   **R**   The *CON own funds requirement* for each *client* or *group of connected clients* in ■ MIFIDPRU 5.7.1R must be calculated by:

(1) determining the own funds requirement for the excess (*OFRE*) in accordance with ■ MIFIDPRU 5.7.3R; and

(2) applying the relevant multiplication factor or factors in accordance with ■ MIFIDPRU 5.7.4R.

5.7.3   **R**   (1) The *OFRE* must be calculated using the following formula:

$$OFRE = \frac{OFR}{EV} \times EVE$$

(2) The *OFR* for an individual *client* is the sum of:

(i) the *TCD own funds requirement* for exposures to that *client*; and

(ii) the *K-NPR requirement* for the exposures to that *client*, subject to (b).

(2) Where exposures arise from the positive excess of a *firm's* long positions over its short positions in all the *trading book financial instruments* issued by the *client* in question, the net position of each instrument calculated using the approach specified for K-NPR in ■ MIFIDPRU 4.12.2R shall only include specific-risk requirements.

(2) A *firm* that calculates a *K-CMG requirement* for a *portfolio* must calculate the *OFR* using the approach specified for K-NPR in ■ MIFIDPRU 4.12.2R, subject to (b).

(2) The *OFR* for a *group of connected clients* must be calculated by adding together the exposures to individual *clients* within the group, and then determining a single own funds requirement for exposures to the group as if the group were a single *undertaking*.

5.7.4   R   (1) Where the excess has persisted for 10 *business days* or less, the *CON own funds requirement* is the *OFRE* multiplied by 200%.

(2) Where the excess has persisted for more than 10 *business days*:

(a) the *EVE* must be apportioned according to the tranches in each row of Column 1 of Table 1;

(b) the proportion of the *EVE* in each tranche must be calculated as a percentage of the overall *EVE*;

(c) the *OFRE* must be pro-rated according to the proportion of *EVE* falling within each tranche;

(d) each portion of the *OFRE* must be multiplied by the relevant Factor in Column 2 of Table 1; and

(e) the *CON own funds requirement* is the sum of the amounts calculated in accordance with (d).

(3) Table 1

Column 1: EVE as a percentage of own funds	Column 2: Factors
For the amount up to and including 40%	200%
For the amount over 40% up to and including 60%	300%
For the amount over 60% up to and including 80%	400%
For the amount over 80% up to and including 100%	500%
For the amount over 100% up to and including 250%	600%
For the amount over 250%	900%

5.7.5   G   (1) K-CON is an additional *K-factor* own funds requirement for *concentration risk* in the *trading book*.

(2) A *firm* must calculate a *CON own funds requirement* for each *client* or *group of connected clients* for which the *exposure value* exceeds the *concentration risk soft limit*. The *CON own funds requirement* for each *client* or *group of connected clients* is then added together determine the *K-CON requirement*.

(3) Determining the *CON own funds requirement* for each *client* or *group of connected clients* involves a two-step calculation:

(a) The first step involves an exposure-based calculation, known as the *OFRE* (the own funds requirement for the excess).

(b) The second step involves applying a multiplying factor to the *OFRE* (or applying different multiplying factors to tranches of the *OFRE*) based on the length of time for which the excess has persisted and by how much (as a percentage of own funds) the *exposure value* exceeds the *concentration risk soft limit*.

(4) The reference to how long an excess has persisted relates to how long a *firm* has had an exposure to a *client* or *group of connected clients* that exceeds the *concentration risk soft limit*, irrespective of whether the constituent parts that make up that total exposure change over the duration of that total exposure.

(5) The 10-*business day* period referred to in ■ MIFIDPRU 5.7.4R runs from the start of the *business day* on which the excess occurred.

5.7.6 |G| The following example shows how to calculate the *CON own funds requirement* for an excess to a *client* that has persisted for 10 *business days* or less:

(1) A *firm* has:

(a) own funds of 1000;

(b) a *concentration risk soft limit* of 250 (25% of 1000);

(c) an *EV* of 262; and

(d) an *EVE* of 12 (262 - 250 = 12).

(2) The exposure is all due to debt securities that have a specific risk own funds requirement of 8% (according to Table 1 in article 336 of *UK CRR)* for the purposes of K-NPR. There is zero K-TCD to this *client*.

In this example, the *OFR* = 262 × 8% = 20.96

(3) To calculate the *OFRE*:

OFRE = OFR/EV*EVE = 20.96/262 ×12 = 0.96

(4) As the excess has persisted for 10 *business days* or less:

CON own funds requirement = 0.96 × 200% = 1.92

5.7.7 |G| The following example shows how to calculate the *CON own funds requirement* for an excess that has persisted for more than 10 *business days*:

(1) A *firm* has:

(a) own funds of 1000;

(b) a *concentration risk soft limit* of 250 (25% of 1000);

(c) an *EV* of 780; and

(d) an *EVE* of 530 (780 - 250 = 530).

(2) The exposure is all due to debt securities that have a specific risk own funds requirement of 8% (according to Table 1 in article 336 of *UK CRR)* for the purposes of K-NPR. There is zero K-TCD to this client.

In this example, the *OFR* = 780 × 8% = 62.4

(3) To calculate the *OFRE*:

OFRE = OFR/EV*EVE = 62.4/780 × 530 = 42.4

(4) As the excess has persisted for more than 10 *business days*, the *CON own funds requirement* is calculated by apportioning the *OFRE* in

accordance with the relevant *EVE* tranche in Table 2, multiplying each part of the *OFRE* by the applicable factor, and then adding the resulting amounts together:

Application of Table 2			
K-CON factor tranche as per Table 1	*EVE* **split by tranche**	*OFRE* **allocated across K-CON tranche by** *EVE* **split**	*CON own funds requirement* (*OFRE* × **factor in Table 1)**
Up to 40%	400	400/530 × 42.4 = 32	32 × 200% = 64
40%-60%	130	130/530 × 42.4 = 10.4	10.4 × 300% = 31.2
Total:	530	42.4	95.2

(5) The *CON own funds requirement* is the total amount in the last column, 95.2.

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