

Chapter 3

Standardised credit risk

3.1 Application and purpose

Application

- 3.1.1 **R** ■ BIPRU 3 applies to a *BIPRU firm*.

Purpose

- 3.1.2 **G** Pursuant to the third paragraph of article 95(2) of the *UK CRR*, ■ BIPRU 3 applies requirements that correspond to:
- (1) Articles 78 to 80, paragraph (1) of Article 81, Article 83, Annex II and Parts 1 and 3 of Annex VI of the *Banking Consolidation Directive*;
 - (2) Article 18 of the *Capital Adequacy Directive* so far as it applies Articles 78 to 80, paragraph (1) of Article 81, Article 83 and Parts 1 and 3 of Annex VI of the *Banking Consolidation Directive* to *investment firms*; and
 - (3) Article 40 of the *Capital Adequacy Directive* for the purposes of the calculation of credit risk under the *Banking Consolidation Directive*.
- 3.1.3 **G** ■ BIPRU 3.1 sets out how a *firm* should calculate the *credit risk capital component*, which is one of the elements that make up the *credit risk capital requirement* under ■ GENPRU 2.1.51 R. Part of that calculation involves calculating *risk weighted exposure amounts* for exposures in the *firm's non-trading book*. The rest of ■ BIPRU 3 sets out how the *firm* should carry out that calculation.
- 3.1.4 **G** ■ BIPRU 5 deals with the effect of *credit risk mitigation* on the calculation of *risk weighted exposure amounts*. ■ BIPRU 13 deals with the calculation of *exposure values* for certain kinds of products. ■ BIPRU 14.3 deals with the calculation of the *counterparty risk capital component* for unsettled transactions in the *trading book* and *non-trading book*. ■ BIPRU 14.4 deals with *capital resources* with respect to *free deliveries*.

Calculation of the credit risk capital component

- 3.1.5 **R** The *credit risk capital component* of a *firm* is 8% of the total of its *risk weighted exposure amounts* for exposures falling into ■ BIPRU 3.1.6 R, calculated in accordance with ■ BIPRU 3.

3.1.6

R An *exposure* falls into this *rule* if:

- (1) it is in a *firm's non-trading book*; and
- (2) it has not been deducted from the *firm's capital resources* under
■ GENPRU 2.2.

3.2 The central principles of the standardised approach to credit risk

- 3.2.1** **R** Subject to ■ BIPRU 13:
- (1) the *exposure* value of an asset item must be its balance-sheet value, subject to any value adjustments required by ■ GENPRU 1.3; and
 - (2) the *exposure* value of an off-balance sheet item listed in the table in ■ BIPRU 3.7.2 R must be the percentage of its value set out in that table.
- [Note: BCD Article 78(1) part]
- 3.2.2** **R** The off-balance sheet items listed in the table in ■ BIPRU 3.7.2 R must be assigned to the risk categories as indicated in that table.
- [Note: BCD Article 78(1) part]
- 3.2.3** **R** Where an *exposure* is subject to *funded credit protection*, a *firm* may modify the *exposure* value applicable to that item in accordance with ■ BIPRU 5.
- [Note: BCD Article 78(3)]
- 3.2.4** **G** ■ BIPRU 13 sets out the method for determination of the *exposure* value of a *financial derivative instrument*, with the effects of contracts of novation and other netting agreements taken into account for the purposes of that method in accordance with ■ BIPRU 13.7.
- [Note: reference to BCD Article 78(2) first sentence. Implementation in ■ BIPRU 13]
- 3.2.5** **G** ■ BIPRU 13.3 and ■ BIPRU 13.8 set out the provisions applying to the treatment and determination of the *exposure* value of *repurchase transactions*, *securities or commodities lending or borrowing transactions*, *long settlement transactions* and *margin lending transactions (SFTs)*.
- [Note: reference to BCD Article 78(2) second sentence. Implementation in ■ BIPRU 13]
- 3.2.6** **G** ■ BIPRU 13 also sets out the methods for the determination of *exposure* values for *long settlement transactions*.

3.2.7 **G** ■ BIPRU 13.8 provides that, in the case of a *firm* using the *financial collateral comprehensive method* under ■ BIPRU 5, where an *exposure* takes the form of an *SFT*, the *exposure* value should be increased by the volatility adjustment appropriate to such *securities* or *commodities* set out in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R (Supervisory volatility adjustments approach and the own estimates of volatility adjustments approach).
 [Note: reference to BCD Article 78(1), part. Implementation in ■ BIPRU 13]

3.2.8 **G** ■ BIPRU 13.3.13 R and ■ BIPRU 13.8.8 R set out the provisions relating to determination of the *exposure* value of certain credit risk *exposures* outstanding with a *central counterparty*, where the *central counterparty* credit risk *exposures* with all participants in its arrangements are fully collateralised on a daily basis.
 [Note: reference to BCD Article 78(4). Implementation in ■ BIPRU 13]

Exposure Classes

3.2.9 **R** A *firm* must assign each *exposure* to one of the following *exposure* classes:

- (1) claims or contingent claims on central governments or *central banks*;
- (2) claims or contingent claims on regional governments or local authorities;
- (3) claims or contingent claims on administrative bodies and non-commercial *undertakings*;
- (4) claims or contingent claims on *multilateral development banks*;
- (5) claims or contingent claims on *international organisation*;
- (6) claims or contingent claims on *institutions*;
- (7) claims or contingent claims on corporates;
- (8) retail claims or contingent retail claims;
- (9) claims or contingent claims secured on real estate property;
- (10) past due items;
- (11) items belonging to regulatory high-risk categories;
- (12) claims in the form of *covered bonds*;
- (13) *securitisation* positions;
- (14) short-term claims on *institutions* and corporates;
- (15) claims in the form of *CIUs*; or
- (16) other items.

[Note: BCD Article 79(1)]

- 3.2.10** **R** To be eligible for the *retail exposure* class, an *exposure* must meet the following conditions:
- (1) the *exposure* must be either to an individual *person* or *persons*, or to a small or medium sized entity;
 - (2) the *exposure* must be one of a significant number of *exposures* with similar characteristics such that the risks associated with such lending are substantially reduced; and
 - (3) the total amount owed to the *firm*, its *parent undertakings* and its *subsidiary undertakings*, including any past due *exposure*, by the obligor client or *group of connected clients*, but excluding claims or contingent claims secured on residential real estate collateral, must not, to the knowledge of the *firm*, exceed €1 million.
- [Note: BCD Article 79(2)]

- 3.2.11** **R** A *firm* must take reasonable steps to acquire the knowledge referred to in ■ BIPRU 3.2.10 R (3).
- [Note: BCD Article 79(2)(c) last sentence]

- 3.2.12** **R** *Securities* are not eligible for the *retail exposure* class.
- [Note: BCD Article 79(2) last sentence]

- 3.2.13** **R** The present value of retail minimum lease payments is eligible for the *retail exposure* class.
- [Note: BCD Article 79(3)]

Retail exposures: Significance

- 3.2.14** **G** A key driver of the preferential *risk weight* afforded *retail exposures* is the lower correlation and systematic risk associated with such *exposures*. This aspect is unrelated to the absolute number of *retail exposures*. Accordingly in defining what constitutes a significant number of *retail exposures* for the purpose of ■ BIPRU 3.2.10 R (2), a *firm* need only satisfy itself that the number of *retail exposures* is sufficiently large to diversify away idiosyncratic risk. This assessment will be subject to supervisory review and part of a *firm's SREP*. It will be looked at as one of the issues relating to overall diversification.

Retail exposures: Aggregation: Reasonable steps

- 3.2.15** **G** In deciding what steps are reasonable for the purposes of ■ BIPRU 3.2.11 R, a *firm* may take into account complexity and cost, as well as the materiality of the impact upon its capital calculation. A *firm* should be able to demonstrate to the *appropriate regulator* that it has complied with the obligation to take reasonable steps under ■ BIPRU 3.2.11 R in the way it takes these factors into account.

Retail exposures: Aggregation: Single risk

- 3.2.16 **G**
- (1) The definition of *group of connected clients* is set out in the *Glossary*. Paragraph (2) of that definition is "two or more *persons* ... who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties".
 - (2) Say that a *firm* has *exposures* to A and B. When deciding whether A and B come within paragraph (2) of the definition two conditions should be satisfied. Firstly the connections between A and B should mean that if A experiences financial problems, B should be likely to encounter repayment difficulties. Secondly, the connections between A and B should mean that if B experiences financial problems, A should be likely to encounter repayment difficulties.
 - (3) The *guidance* in **■ BIPRU 3.2.16 G** is provided for the purpose of **■ BIPRU 3.2.10 R** only and not for the purposes of any other provision in the Handbook that uses the defined term *group of connected clients*.

Retail exposures: Aggregation: Personal and business exposures

- 3.2.17 **G**
- If a *firm* has *exposures* to an owner of a *retail SME* in his personal capacity and *exposures* to the *retail SME* the *firm* should aggregate the two types of *exposure* for the purpose of **■ BIPRU 3.2.10 R** (3), although it should not include claims secured on residential real estate collateral. In deciding what steps are reasonable for the purposes of **■ BIPRU 3.2.11 R** in aggregating these two types of *exposure*, a *firm* may take into account the materiality of those personal *exposures*. A *firm* should be able to demonstrate to the *appropriate regulator* that it has complied with the obligation to take reasonable steps under **■ BIPRU 3.2.11 R** when taking into account materiality in this way.

Retail exposures: Exchange rate

- 3.2.18 **G**
- Where an exposure is denominated in a currency other than the euro, a *firm* may calculate the euro equivalent for purposes of **■ BIPRU 3.2.10 R** using any appropriate set of exchange rates provided its choice has no obvious bias and that the *firm* is consistent in its approach to choosing rates.

Retail exposures: Frequency of monitoring

- 3.2.19 **G**
- A *firm* may monitor compliance with the €1m threshold in **■ BIPRU 3.2.10 R** on the basis of approved limits provided it has internal control procedures that are sufficient to ensure that amounts owed cannot diverge from approved limits to such an extent as to give rise to a material breach of the €1m threshold.

- 3.2.20 **R**
- (1) To calculate *risk weighted exposure amounts*, *risk weights* must be applied to all *exposures*, unless deducted from *capital resources*, in accordance with the provisions of **■ BIPRU 3.4**.

(2) The application of *risk weights* must be based on the *standardised credit risk exposure class* to which the *exposure* is assigned and, to the extent specified in ■ BIPRU 3.4, its credit quality.

(3) Credit quality may be determined by reference to:

- (a) the credit assessments of *eligible ECAs* in accordance with the provisions of ■ BIPRU 3; or
- (b) the credit assessments of export credit agencies as described in ■ BIPRU 3.4.

[Note: BCD Article 80(1)]

3.2.21 **R** For the purposes of applying a *risk weight*, as referred to in ■ BIPRU 3.2.20 R, the *exposure* value must be multiplied by the *risk weight* specified or determined in accordance with the *standardised approach*.

[Note: BCD Article 80(2)]

3.2.22 **R** Notwithstanding ■ BIPRU 3.2.20 R, where an *exposure* is subject to credit protection the *risk weight* applicable to that item may be modified in accordance with ■ BIPRU 5.

[Note: BCD Article 80(4)]

3.2.23 **R** *Risk weighted exposure amounts* for *securitised exposures* must be calculated in accordance with ■ BIPRU 9.

[Note: BCD Article 80(5)]

3.2.24 **R** *Exposures* the calculation of *risk weighted exposure amounts* for which is not otherwise provided for under the *standardised approach* must be assigned a *risk weight* of 100%.

[Note: BCD Article 80(6)]

Zero risk-weighting for intra-group exposures: core UK group

3.2.25 **R** (1) Subject to ■ BIPRU 3.2.35 R, and with the exception of *exposures* giving rise to liabilities in the form of the items referred to in ■ BIPRU 3.2.26 R, a *firm* is not required to comply with ■ BIPRU 3.2.20 R (Calculation of risk weighted exposures amounts under the standardised approach) in the case of the *exposures* of the *firm* to a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking* provided that the following conditions are met:

- (a) the counterparty is
 - (i) a *core concentration risk group counterparty*; and
 - (ii) an *institution, financial holding company, mixed financial holding company, financial institution, asset management company* or *ancillary services undertaking* subject to appropriate prudential requirements;

(b) [deleted]

<p>(b) (in relation to a <i>subsidiary undertaking</i>) 100% of the voting rights attaching to the <i>shares</i> in the counterparty's capital is held by the <i>firm</i> or a <i>financial holding company</i> (or a <i>subsidiary undertaking</i> of the <i>financial holding company</i>), whether individually or jointly, and that the <i>firm</i> or <i>financial holding company</i> (or its <i>subsidiary undertaking</i>) must have the right to appoint or remove a majority of the members of the board of <i>directors</i>, committee of management or other governing body of the counterparty;</p> <p>(c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the <i>firm</i>;</p> <p>(d) the counterparty is incorporated in the <i>United Kingdom</i> ; and</p> <p>(e) there is no current or foreseen material practical or legal impediment to the prompt transfer of <i>capital resources</i> or repayment of liabilities from the counterparty to the <i>firm</i>.</p> <p>(2) Where a <i>firm</i> chooses under (1) not to apply ■ BIPRU 3.2.20 R, it must assign a <i>risk weight</i> of 0% to the <i>exposure</i>.</p> <p>(3) A <i>firm</i> need not apply the treatment in (1) and (2) to every <i>exposure</i> that is eligible for that treatment.</p> <p>[Note: BCD Article 80(7)]</p>	<p>3.2.25A</p>	<p>G</p>	<p>(1) [deleted]</p> <p>(2) [deleted]</p>
<p>A <i>firm</i> must not apply the treatment in ■ BIPRU 3.2.25 R to <i>exposures</i> giving rise to liabilities in the form of any of the following items:</p> <p>(1) in the case of a <i>BIPRU firm</i>, any <i>tier one capital</i> or <i>tier two capital</i>; and</p> <p>(2) in the case of any other <i>undertaking</i>, any item that would be <i>tier one capital</i> or <i>tier two capital</i> if the <i>undertaking</i> were a <i>BIPRU firm</i>.</p> <p>[Note: BCD Article 80(7), part]</p>	<p>3.2.26</p>	<p>R</p>	
<p>(1) [deleted]</p> <p>(a) [deleted]</p> <p>(b) [deleted]</p> <p>(c) [deleted]</p> <p>(2) [deleted]</p>	<p>3.2.27</p>	<p>R</p>	
<p>(1) For the purpose of ■ BIPRU 3.2.25R (1)(e), a <i>firm</i> must be able on an ongoing basis to demonstrate fully to the <i>appropriate regulator</i> the circumstances and arrangements, including legal arrangements, by virtue of which there are no material practical or legal impediments, and none are foreseen, to the prompt transfer of <i>capital resources</i> or repayment of liabilities from the counterparty to the <i>firm</i>.</p>	<p>3.2.27A</p>	<p>R</p>	

- (2) In relation to a counterparty that is not a *firm*, the arrangements referred to in (1) must include a legally binding agreement with each *firm* that is a member of the *core UK group* that it will promptly on demand by the *firm* increase the *firm's capital resources* by an amount required to ensure that the *firm* complies with ■ GENPRU 2.1 (Calculation of capital resources requirements) and any other requirements relating to *capital resources* or concentration risk imposed on a *firm* by or under the *regulatory system*.
- (3) For the purpose of (2), the obligation to increase the *firm's capital resources* may be limited to capital resources available to the *counterparty* and may reasonably exclude such amount of capital resources that, if transferred to the *firm*, would cause the *counterparty* to become balance sheet insolvent in the manner contemplated in section 123(2) of the Insolvency Act 1986.
- 3.2.28 **G** For the purpose of ■ BIPRU 3.2.25 R (1)(c) it is the risk management functions of the group that should be integrated, rather than the group's operational management. A *firm* should ensure that if risk management functions are integrated in this way it should be possible for the *appropriate regulator* to undertake qualitative supervision of the management of the integrated risk management function.
- 3.2.29 **G** In relation to a *core concentration risk group counterparty*, an *undertaking* is included within the scope of consolidation of a group on a full basis if it is at the head of the group or if its assets and liabilities are taken into account in full as referred to in ■ BIPRU 8.5.2 G (Basis of inclusion of undertakings in consolidation).
- 3.2.29A **G**
- (1) In relation to ■ BIPRU 3.2.25 R (1)(ba), a *subsidiary undertaking* should generally be 100% owned and controlled by a single shareholder. However, if a *subsidiary undertaking* has more than one shareholder, that *undertaking* may be a member of the *core UK group* if all its shareholders are also members of the same *core UK group*.
- (2) For the purpose of ■ BIPRU 3.2.25 R (1)(d) (Incorporation in the UK), if a counterparty is of a type that falls within the scope of the *Insolvency Proceedings Regulation* and it is established in the *United Kingdom* other than by incorporation, a *firm* wishing to include that counterparty in its *core UK group* may apply to the *appropriate regulator* for a *waiver* of this condition if it can demonstrate fully to the *appropriate regulator* that the counterparty's centre of main interests is situated in the *United Kingdom* within the meaning of that Regulation.
- 3.2.30 **G** For the purpose of ■ BIPRU 3.2.25 R (1)(e) (Prompt transfer of capital resources):
- (1) in the case of an *undertaking* that is a *firm* the requirement in ■ BIPRU 3.2.25 R (1)(e) for the prompt transfer of *capital resources* refers to *capital resources* in excess of the capital and financial resources requirements to which it is subject under the *regulatory system*; and
- (2) [deleted]

- (3) the *FCA* will consider the following criteria:
- (a) the speed with which funds can be transferred or liabilities repaid to the *firm* and the simplicity of the method for the transfer or repayment;
 - (b) whether there are any interests other than those of the *firm* in the *core concentration risk group counterparty* and what impact those other interests may have on the *firm's* control over the *core group concentration risk group counterparty* and the ability of the *firm* to require a transfer of funds or repayment of liabilities;
 - (c) whether there are any tax disadvantages for the *firm* or the *core concentration risk group counterparty* as a result of the transfer of funds or repayment of liabilities;
 - (d) whether the purpose of the *core concentration risk group counterparty* prejudices the prompt transfer of funds or repayment of liabilities;
 - (e) whether the legal structure of the *core concentration risk group counterparty* prejudices the prompt transfer of funds or repayment of liabilities;
 - (f) whether the contractual relationships of the *core concentration risk group counterparty* with the *firm* and other third parties prejudices the prompt transfer of funds or repayment of liabilities; and
 - (g) whether past and proposed flows of funds between the *core concentration risk group counterparty* and the *firm* demonstrate the ability to make prompt transfer of funds or repayment of liabilities.

- 3.2.31 **G** The requirement in ■ BIPRU 3.2.25 R (1)(e) for the prompt repayment of liabilities refers to the prompt repayment of liabilities when due.
- 3.2.32 **G** The *guidance* in ■ BIPRU 3.2.30 G - ■ BIPRU 3.2.31 G does not apply to ■ BIPRU 2.1 (Solo consolidation) even though the provisions have similar wording. This is because the purpose of the provisions in ■ BIPRU 2.1 is to define the conditions under which two *undertakings* should be treated as a single *undertaking*. The purpose of ■ BIPRU 3.2.25 R (1) is to define the circumstances in which it is appropriate to apply a zero *risk weight*.
- 3.2.33 **G** A *firm* that has chosen to apply the treatment in ■ BIPRU 3.2.25 R should monitor the *exposures* to which a 0% *risk weight* is applied under that treatment and report these to the *appropriate regulator* as required.
- 3.2.34 **G** If a *firm* has an *IRB permission* and *exposures* are exempted from the *IRB approach* under ■ BIPRU 4.2.26 R (6) the *firm* may apply a 0% *risk weight* to them under ■ BIPRU 3.2.25 R (2) (Zero risk weighting for intra-group exposures) if the conditions in ■ BIPRU 3.2.25 R (1) are satisfied.
- 3.2.35 **R** (1) A *firm* may not apply ■ BIPRU 3.2.25 R unless it has a *core UK group waiver*.

- (2) [deleted]
- (3) A *firm* may stop applying ■ BIPRU 3.2.25 R or may stop applying it to some *exposures*.
- (4) [deleted]
- (5) A *firm* must notify the *appropriate regulator* if it becomes aware that any *exposure* that it has treated as exempt under ■ BIPRU 3.2.25 R has ceased to meet the conditions for exemption or if the *firm* ceases to treat an *exposure* under that *rule*.

3.2.36 **G** [deleted]

3.2.37 **G** ■ BIPRU 3 Annex 1 G is a flow chart guide to assessing whether an intra-group *exposure* can be zero *risk weighted* using the *standardised approach* subject to the conditions set out in ■ BIPRU 3.2.25 R - ■ BIPRU 3.2.35 R.

Exposures to recognized third-country investment firms, clearing houses and investment exchanges

3.2.38 **R** For the purposes of the *standardised approach* (including as it applies for the purposes of ■ BIPRU 14) and without prejudice to ■ BIPRU 13.3.13 R and ■ BIPRU 13.8.8 R (Exposure to a central counterparty), *exposures to recognised third country investment firms* and *exposures to recognised clearing houses, designated clearing houses, recognised investment exchanges and designated investment exchanges* must be treated as exposures to *institutions*.

[Note: CAD Article 40]



3.3 The use of the credit assessments of ratings agencies

3.3.1 **R** An external credit assessment may be used to determine the *risk weight* of an *exposure* in accordance with ■ BIPRU 3.2.20 R to ■ BIPRU 3.2.26 R only if the *ECAI* which provides it is recognised by the *appropriate regulator* as an *eligible ECAI* for the purposes of the standardised approach to credit risk.
 [Note: BCD Article 81(1)]

Recognition of ratings agencies

3.3.2 **G** The *appropriate regulator* will recognise an *ECAI* as an *eligible ECAI* for the purposes of ■ BIPRU 3, or will refuse to recognise an *ECAI* or will revoke its recognition of an *ECAI* as an *eligible ECAI* in accordance with the *Capital Requirements Regulations 2006*.

3.3.3 **G** Regulation 22 of the *Capital Requirements Regulations 2006* deals with recognition by the *appropriate regulator* of *eligible ECAs* for *exposure risk weight* purposes. Regulation 25 deals with revoking recognition.

3.3.4 **G** The criteria which the *appropriate regulator* must apply when assessing *ECAs* for recognition for *exposure risk weighting* purposes are set out in Regulation 22 and Schedule 1 to the *Capital Requirements Regulations 2006*. In making an assessment against those criteria and in carrying out the mapping process described in ■ BIPRU 3.3.7 G to ■ BIPRU 3.3.9 G the *appropriate regulator* will have regard to the approach set out in the Committee of European Banking Supervisors' "Guidelines on the recognition of External Credit Assessment Institutions" dated 20 January 2006. The *appropriate regulator* does not expect to recognise an *ECAI* unless the information set out in those guidelines has been submitted to it.

3.3.5 **G** The list of *eligible ECAs* is published on the *appropriate regulator* website. When the *appropriate regulator* recognises an *ECAI* as an *eligible ECAI*, it publishes that decision by amending the list of *eligible ECAs* on the *appropriate regulator* website to include the name of the *eligible ECAI*. When the *appropriate regulator* determines that the recognition of an *ECAI* should be revoked, it publishes that decision by deleting the name of the *ECAI* from the list on the *appropriate regulator* website

3.3.6 **G** [deleted]

Mapping of credit assessments

- 3.3.7 **G** Under Regulation 22(3) of the *Capital Requirements Regulations 2006* the *appropriate regulator* is obliged to determine, taking into account the requirements set out in Schedule 2 to the *Capital Requirements Regulations 2006*, with which of the *credit quality steps* set out in Part 1 of Annex VI of the *Banking Consolidation Directive* the relevant credit assessments of an *eligible ECAI* are to be associated. Those determinations should be objective and consistent.
- 3.3.8 **R** The *credit quality step* with which a relevant credit assessment of an *eligible ECAI* is to be associated is that in the table mapping the credit assessments of *eligible ECAs* to *credit quality steps* published by the *appropriate regulator* under Regulation 22(3) of the *Capital Requirements Regulations 2006*.
- 3.3.9 **G** The table mapping the credit assessments of *eligible ECAs* to *credit quality steps* is published on the *appropriate regulator's* website and amended from time to time in line with additions to and deletions from the list of *eligible ECAs*.

[**Note:** For the most recent version of the table, refer to: <http://www.fca.org.uk/your-fca/documents/fsa-ecais-standardised> for the *FCA* and <http://www.bankofengland.co.uk/publications/Documents/other/pr/policy/2013/ecaisstandardised.pdf> for the *PRA*]



3.4 Risk weights under the standardised approach to credit risk

Risk weights: Exposures to central governments or central banks: Treatment

3.4.1 **R** Without prejudice to ■ BIPRU 3.4.2 R to ■ BIPRU 3.4.9 R, exposures to central governments and central banks must be assigned a 100% *risk weight*.
 [Note: BCD Annex VI Part 1 point 1]

3.4.2 **R** Subject to ■ BIPRU 3.4.4 R, *exposures* to central governments and *central banks* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.3 R in accordance with the assignment by the *appropriate regulator* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAs* to six steps in a *credit quality assessment scale*.
 [Note: BCD Annex VI Part 1 point 2]

Table: Exposures to central governments and central banks for which a credit assessment by a nominated ECAI is available

3.4.3 **R** This table belongs to ■ BIPRU 3.4.2 R.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	0 %	20 %	50 %	100 %	100 %	150 %

3.4.4 **R** *Exposures* to the European Central Bank must be assigned a 0% *risk weight*.
 [Note: BCD Annex VI Part 1 point 3]

Exposures in the national currency of the borrower

3.4.5 **R** *Exposures* to the central government of the *UK* and the Bank of England denominated and funded in sterling must be assigned a *risk weight* of 0%.
 [Note: BCD Annex VI Part 1 point 4]

3.4.6 **R** When the *competent authorities* of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the *UK* assign a *risk weight* which is lower than that indicated in ■ BIPRU 3.4.1 R to

■ BIPRU 3.4.3 R to *exposures* to their central government and *central bank* denominated and funded in the domestic currency, a *firm* may *risk weight* such *exposures* in the same manner.

[Note: BCD Annex VI Part 1 point 5]

Use of credit assessments by export credit agencies

3.4.7

R

An export credit agency credit assessment may be recognised by a *firm* for the purpose of determining the *risk weight* to be applied to an *exposure* under the *standardised approach* if either of the following conditions is met:

- (1) the credit assessment is a consensus risk score from export credit agencies participating in the OECD "Arrangement on Guidelines for Officially Supported Export Credits"; or
- (2) the export credit agency publishes its credit assessments, and the export credit agency subscribes to the OECD agreed methodology, and the credit assessment is associated with one of the eight minimum export insurance premiums (MEIP) that the OECD agreed methodology establishes.

[Note: BCD Annex VI Part 1 point 6]

3.4.8

R

Exposures for which a credit assessment by an export credit agency is recognised for *risk weighting* purposes must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.9 R.

[Note: BCD Annex VI Part 1 point 7]

Table: Exposure for which a credit assessment by an export credit agency is recognised

3.4.9

R

This table belongs to ■ BIPRU 3.4.8 R.

MEIP	0	1	2	3	4	5	6	7
Risk weight	0%	0%	20%	50%	100%	100%	100%	150%

Exposures to regional governments or local authorities: General

3.4.10

R

Without prejudice to ■ BIPRU 3.4.15 R to ■ BIPRU 3.4.19 R:

- (1) a *firm* must *risk weight exposures* to regional governments and local authorities in accordance with ■ BIPRU 3.4.11 R to ■ BIPRU 3.4.14 R; and
- (2) the preferential treatment for short-term *exposures* specified in ■ BIPRU 3.4.37 R, ■ BIPRU 3.4.39 R and ■ BIPRU 3.4.44 R must not be applied.

[Note: BCD Annex VI Part 1 point 8]

Exposures to regional governments or local authorities: Central government risk weight based method

- 3.4.11** **R** (1) *Exposures* to regional governments and local authorities must be assigned a *risk weight* according to the *credit quality step* to which *exposures* to the central government of the jurisdiction in which the regional government or local authority is established are assigned in accordance with the table in ■ BIPRU 3.4.12 R.
- (2) *Exposures* to an unrated regional government or local authority must not be assigned a *risk weight* lower than that applied to *exposures* to its central government.

[Note: BCD Annex VI Part 1 points 25 and 26]

Table: Central government risk weight based method

3.4.12 **R** This table belongs to ■ BIPRU 3.4.11 R.

<i>Credit quality step</i> to which central government is assigned	1	2	3	4	5	6
<i>Risk weight of exposure</i>	20%	50%	100%	100%	100%	150%

3.4.13 **R** For *exposures* to regional governments and local authorities established in countries where the central government is unrated, the *risk weight* must be not more than 100%.

[Note: BCD Annex VI Part 1 point 27]

3.4.14 **R** For *exposures* to regional governments and local authorities with an original effective maturity of three months or less, the *risk weight* must be 20%.

[Note: BCD Annex VI Part 1 point 28]

3.4.15 **R** A *firm* must treat an *exposure* to a regional government or local authority of the *United Kingdom* listed in ■ BIPRU 3 Annex 2 R as an *exposure* to the central government of the *United Kingdom*.

[Note: BCD Annex VI Part 1 point 9]

3.4.16 **G** The *appropriate regulator* will include a regional government or local authority in the list in ■ BIPRU 3 Annex 2 R where there is no difference in risk between *exposures* to that body and *exposures* to the central government of the *United Kingdom* because of the specific revenue-raising powers of the regional government or local authority, and the existence of specific institutional arrangements the effect of which is to reduce the risk of default.

[Note: BCD Annex VI Part 1 point 9]

- 3.4.17 **R** [deleted]
- 3.4.18 **R** *Exposures to churches or religious communities constituted in the form of a legal person under public law must, in so far as they raise taxes in accordance with legislation conferring on them the right to do so, be treated as exposures to regional governments and local authorities, except that*
 ■ BIPRU 3.4.15 R does not apply.
 [Note: BCD Annex VI Part 1 point 10]
- 3.4.19 **R** When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the UK treat *exposures* to regional governments and local authorities as *exposures* to their central government, a *firm* may *risk weight exposures* to such regional governments and local authorities in the same manner.
 [Note: BCD Annex VI Part 1 point 11]
- 3.4.19A **R** [deleted]
- Exposures to administrative bodies and non-commercial undertakings**

- 3.4.20 **R** ■ BIPRU 3.4.21 R to ■ BIPRU 3.4.26 R set out the provisions applying to *exposures* to administrative bodies and non-commercial *undertakings*.
- Treatment**

- 3.4.21 **R** Without prejudice to ■ BIPRU 3.4.22 R to ■ BIPRU 3.4.26 R, *exposures* to administrative bodies and non-commercial *undertakings* must be assigned a 100% *risk weight*.
 [Note: BCD Annex VI Part 1 point 12]
- Public sector entities**

- 3.4.22 **R** Without prejudice to ■ BIPRU 3.4.23 R to ■ BIPRU 3.4.26 R, *exposures* to *public sector entities* must be assigned a 100% *risk weight*.
 [Note: BCD Annex VI Part 1 point 13]

3.4.23 **R** A firm may treat an exposure to a public sector entity as an exposure to a regional government or local authority in accordance with ■ BIPRU 3.4.11 R to ■ BIPRU 3.4.14 R.

[Note: BCD Annex VI Part 1 point 14]

3.4.24 **R** In exceptional circumstances a firm may treat an exposure to a public sector entity established in the United Kingdom as an exposure to the central government of the United Kingdom if there is no difference in risk between exposures to that body and exposures to the central government of the United Kingdom because of the existence of an appropriate guarantee by the central government.

[Note: BCD Annex VI Part 1 point 15]

3.4.25 **R** [deleted]

3.4.26 **R** When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the UK, treat exposures to public sector entities as exposures to institutions, a firm may risk weight exposures to the relevant public sector entities in the same manner.

[Note: BCD Annex VI Part 1 point 17]

Exposures to multilateral development banks: Treatment

3.4.27 **R** Without prejudice to ■ BIPRU 3.4.28 R to ■ BIPRU 3.4.29 R:

(1) a firm must treat exposures to multilateral development banks in the same manner as exposures to institutions in accordance with ■ BIPRU 3.4.34 R to ■ BIPRU 3.4.39 R (Exposures to institutions: credit assessment based method); and

(2) the preferential treatment for short-term exposures specified in ■ BIPRU 3.4.37 R, ■ BIPRU 3.4.39 R and ■ BIPRU 3.4.44 R must not be applied.

[Note: BCD Annex VI Part 1 point 19]

3.4.28 **R** An exposure to a multilateral development bank listed in point (a) of the definition in the Glossary must be assigned a 0% risk weight.

[Note: BCD Annex VI Part 1 point 20]

3.4.29 **R** [deleted]

Exposures to international organisations

3.4.30 **R** Exposures to the following international organisations must be assigned a 0% risk weight:

(1) the EU;

- (2) the International Monetary Fund; and
- (3) the Bank for International Settlements.

[Note: BCD Annex VI Part 1 point 22]

Exposures to institutions: General

3.4.31 **R** ■ BIPRU 3.4.32 R to ■ BIPRU 3.4.47R set out the treatment to be accorded to exposures to institutions.

Exposures to institutions: Treatment

3.4.32 **R** Without prejudice to ■ BIPRU 3.4.33 R to ■ BIPRU 3.4.47 R, exposures to financial institutions authorised and supervised by the PRA and FCA and subject to prudential requirements equivalent to those applied to credit institutions must be risk weighted as exposures to institutions.

[Note: BCD Annex VI Part 1 point 24]

Exposures to institutions: Risk weight floor on exposures to unrated institutions

3.4.33 **R** Exposures to an unrated institution must not be assigned a risk weight lower than that applied to exposures to its central government.

[Note: BCD Annex VI Part 1 point 25]

Exposures to institutions: Credit assessment based method

3.4.34 **R** Exposures to institutions with a residual maturity of more than three months for which a credit assessment by a nominated ECAI is available must be assigned a risk weight according to the table in ■ BIPRU 3.4.35 R in accordance with the assignment by the appropriate regulator in accordance with the Capital Requirements Regulations 2006 of the credit assessments of eligible ECAs to six steps in a credit quality assessment scale.

[Note: BCD Annex VI Part 1 point 29]

Table: Exposures to institutions with a residual maturity of more than three months for which a credit assessment by a nominated ECAI is available

3.4.35 **R** This table belongs to ■ BIPRU 3.4.34 R.

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	50%	100%	100%	150%

3.4.36 **R** Without prejudice to ■ BIPRU 3.4.33 R, *exposures to unrated institutions* must be assigned a *risk weight* of 50%.
 [Note: BCD Annex VI Part 1 point 30]

3.4.37 **R** *Exposures to an institution with a residual maturity of three months or less for which a credit assessment by a nominated ECAI is available* must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.38 R in accordance with the assignment by the *appropriate regulator* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAIs* to six steps in a *credit quality assessment scale*.
 [Note: BCD Annex VI Part 1 point 31]

Table: Exposures to an institution with a residual maturity of three months or less for which a credit assessment by a nominated ECAI is available

3.4.38 **R** This table belongs to ■ BIPRU 3.4.37 R.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	20%	20%	50%	50%	150%

3.4.39 **R** Without prejudice to ■ BIPRU 3.4.33 R, *exposures to unrated institutions* having an original effective maturity of three months or less must be assigned a 20% *risk weight*.
 [Note: BCD Annex VI Part 1 point 32]

Exposures to institutions: Interaction with short-term credit assessments

3.4.40 **R** If there is no short-term credit assessment as set out in ■ BIPRU 3.4.112 R, the general preferential treatment for short-term *exposures* as specified in ■ BIPRU 3.4.37 R applies to all *exposures to institutions* of up to three months residual maturity.
 [Note: BCD Annex VI Part 1 point 34]

3.4.41 **R** If there is a short-term credit assessment as set out in ■ BIPRU 3.4.112 R and such an assessment determines the application of a more favourable or identical *risk weight* than the use of the general preferential treatment for short-term *exposures*, as specified in ■ BIPRU 3.4.37 R, then the short-term assessment and *risk weighting* specified in ■ BIPRU 3.4.112 R must be used for that specific *exposure* only. Other short-term *exposures* must follow the general preferential treatment for short-term *exposures*, as specified in ■ BIPRU 3.4.37 R.
 [Note: BCD Annex VI Part 1 point 35]

3.4.42 **R** If there is a short-term credit assessment as set out in ■ BIPRU 3.4.112 R and such an assessment determines a less favourable *risk weight* than the use of the general preferential treatment for short-term *exposures*, as specified in ■ BIPRU 3.4.37 R, then the general preferential treatment for short-term

exposures must not be used and all unrated short-term claims must be assigned the same *risk weight* as that applied by the specific short-term assessment.

[Note: BCD Annex VI Part 1 point 36]

3.4.43

G

■ BIPRU 3 Annex 4 G contains a flow diagram guide to determining the *risk weight* to be applied to short-term *exposures* to *institutions* according to whether a short-term credit assessment is available.

Exposures to institutions: Short-term exposures in the national currency of the borrower

3.4.44

R

A *firm* may assign to an *exposure* to an *institution* formed under the law of the *United Kingdom* of a residual maturity of 3 months or less denominated and funded in pounds sterling a *risk weight* that is one category less favourable than the preferential *risk weight*, as described in ■ BIPRU 3.4.5 R (Exposures in the national currency of the borrower), assigned to *exposures* to the central government of the *United Kingdom*.

[Note: BCD Annex VI Part 1 point 37]

3.4.45

R

- (1) [deleted]
- (2) When the *competent authority* of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the *EEA* assigns to an *exposure* to an *institution* formed under the law of that third country of a residual maturity of 3 months or less denominated and funded in the national currency a *risk weight* that is one category less favourable than the preferential *risk weight*, as described in ■ BIPRU 3.4.6 R (Exposures in the national currency of the borrower), assigned to *exposures* to the central government of that third country, a *firm* may *risk weight* such *exposures* in the same manner.

[Note: BCD Annex VI Part 1 point 37]

3.4.46

R

No *exposures* of a residual maturity of 3 months or less denominated and funded in the national currency of the borrower may be assigned a *risk weight* less than 20%.

[Note: BCD Annex VI Part 1 point 38]

Exposures to institutions: Investments in regulatory capital instruments

3.4.47

R

Investments in *equity* or regulatory capital instruments issued by *institutions* must be *risk weighted* at 100%, unless deducted from *capital resources*.

[Note: BCD Annex VI Part 1 point 39]

3.4.48 **R** [deleted]

Exposures to corporates: General

3.4.49 **G** ■ BIPRU 3.4.50 R to ■ BIPRU 3.4.52 R set out the treatment to be accorded to *exposures to corporates*.

Exposures to corporates: Treatment

3.4.50 **R** *Exposures* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.51 R in accordance with the assignment by the *appropriate regulator* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAs* to six steps in a *credit quality assessment scale*.

[Note: BCD Annex VI Part 1 point 41]

Table: Exposures for which a credit assessment by a nominated ECAI is available

3.4.51 **R** This table belongs to ■ BIPRU 3.4.50 R.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	50%	100%	100%	150%	150%

3.4.52 **R** Unrated *exposures* must be assigned a 100% *risk weight* or the *risk weight* of its central government, whichever is the higher.

[Note: BCD Annex VI Part 1 point 42]

Retail exposures

3.4.53 **R** *Exposures* that comply with the criteria listed in ■ BIPRU 3.2.10 R must be assigned a *risk weight* of 75%. However a *firm* may treat such an *exposure* under ■ BIPRU 3.2.24 R (100% *risk weight*).

[Note: BCD Annex VI Part 1 point 43]

Exposures secured by real estate property

3.4.54 **R** ■ BIPRU 3.4.55 R to ■ BIPRU 3.4.89R set out the treatment to be accorded to *exposures* secured by real estate property.

3.4.55 **R** Without prejudice to ■ BIPRU 3.4.56 R to ■ BIPRU 3.4.94 R, *exposures* fully secured by real estate property must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 44]

Exposures secured by mortgages on residential property

3.4.56 **R** Without prejudice to ■ BIPRU 3.4.85 R, an *exposure* or any part of an *exposure* fully and completely secured, to the satisfaction of the *firm*, by mortgages on residential property which is or shall be occupied or let by the owner or the

beneficial owner in the case of personal investment companies must be assigned a *risk weight* of 35%.

[Note: BCD Annex VI Part 1 point 45]

3.4.56A R

- (1) A *firm* must not treat a *lifetime mortgage* as an *exposure* fully and completely secured on residential property for the purposes of ■ BIPRU 3.4.56 R unless the amount of the *exposure* is calculated according to the following formula:

exposure amount =

$$\frac{P(1+i)^T}{(1+d)^T}$$

where:

- (a) *P* is the current outstanding balance on the *lifetime mortgage*;
 - (b) *i* is the interest rate charged on the *lifetime mortgage*, which for the purposes of this calculation must not be lower than the discount rate referred to in (c);
 - (c) *d* is the discount rate which is the risk-free rate as represented by the yield on 10-year UK government bonds; and
 - (d) *T* is the projected number of years to maturity of the *exposure*.
- (2) Notwithstanding (1)(c), a *firm* may calculate an annual average discount rate provided there is no obvious bias in its calculation and it is consistent in its approach.

- 3.4.56B** **G** (1) This paragraph provides *guidance* on ■ BIPRU 3.4.56A R.
- (2) For the purposes of ■ BIPRU 3.4.56A R (2), a *firm* may use the FTSE UK gilt 10-year yield index which the Council of Mortgage Lenders makes available to its members.
- (3) If a *firm* offers a variable interest rate on a *lifetime mortgage*, it should calculate an average interest rate in a way which is consistent with the calculation of the discount rate.
- (4) To determine the projected number of years to maturity of the *exposure*, a *firm* may use the standard mortality tables published by the Institute of Actuaries or the Faculty of Actuaries. For internal risk management purposes, the *firm* should use factual data or seek actuarial advice to determine how the information in these tables may be adjusted to take account of regional and other relevant variations.
- 3.4.57** **R** [deleted]
- 3.4.58** **R** Without prejudice to ■ BIPRU 3.4.85 R, an *exposure* or any part of an *exposure* to a tenant under a property leasing transaction concerning residential property under which the *firm* is the lessor and the tenant has an option to purchase, must be assigned a *risk weight* of 35% provided that the *firm* is satisfied that the *exposure* of the *firm* is fully and completely secured by its ownership of the property.
- [Note: BCD Annex VI Part 1 point 47]
- 3.4.59** **G** An Ijara mortgage is an example of an *exposure* described in ■ BIPRU 3.4.58 R.
- 3.4.60** **R** (1) In the exercise of its judgement for the purposes of ■ BIPRU 3.4.56 R to ■ BIPRU 3.4.58 R, a *firm* may be satisfied only if the conditions in (2) to (6) are met.
- (2) The value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macroeconomic factors affect both the value of the property and the performance of the borrower.
- (3) The risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.
- (4) The minimum requirements about:
- (a) legal certainty in ■ BIPRU 3.4.64 R;
 - (b) monitoring of property values in ■ BIPRU 3.4.66 R;
 - (c) documentation in ■ BIPRU 3.4.72 R; and
 - (d) insurance in ■ BIPRU 3.4.73 R;

are met.

(5) The valuation *rules* set out in ■ BIPRU 3.4.77 R to ■ BIPRU 3.4.80 R are met.

(6) The value of the property exceeds the *exposures* by a substantial margin as set out in ■ BIPRU 3.4.81 R, ■ BIPRU 3.4.84 R or ■ BIPRU 3.4.85 R (as applicable).

[Note: BCD Annex VI Part 1 point 48]

3.4.61 ■ **R** ■ BIPRU 3.4.60 R (3) does not apply to *exposures* fully and completely secured by mortgages on residential property which is situated within the *United Kingdom*.

[Note: BCD Annex VI Part 1 point 49]

3.4.62 ■ **G** The *FCA* may disapply the condition in ■ BIPRU 3.4.60 R (3), if it has evidence that a well-developed and long-established residential real estate market is present in the *UK* with loss rates which are sufficiently low to justify disapplying the condition in ■ BIPRU 3.4.60R(3). ■ BIPRU 3.4.61 R implements that option. However, if the evidence changes so that these conditions are no longer satisfied, the *appropriate regulator* may revoke ■ BIPRU 3.4.61 R.

3.4.63 ■ **R** [deleted]

3.4.64 ■ **R** The requirements about legal certainty referred to in ■ BIPRU 3.4.60 R (4)(a) are as follows:

- (1) the mortgage or charge must be enforceable in all relevant jurisdictions which are relevant at the time of conclusion of the credit agreement, and the mortgage or charge must be properly filed on a timely basis;
- (2) the arrangements must reflect a perfected lien (i.e. all legal requirements for establishing the pledge shall have been fulfilled); and

(3) the protection agreement and the legal process underpinning it must enable the *firm* to realise the value of the protection within a reasonable timeframe.

[Note: BCD Annex VIII Part 2 point 8(a)]

3.4.65 **G** The term protection agreement in **■ BIPRU 3.4.64 R (3)** refers to the contract or deed by which the mortgage or charge is established.

3.4.66 **R**

(1) The requirements about monitoring of property values referred to in **■ BIPRU 3.4.60 R (4)(b)** are as follows:

- (a) the value of the property must be monitored on a frequent basis and at a minimum once every three years for residential real estate;
- (b) more frequent monitoring must be carried out where the market is subject to significant changes in conditions;
- (c) statistical methods may be used to monitor the value of the property and to identify property that needs revaluation;
- (d) the property valuation must be reviewed by an independent valuer when information indicates that the value of the property may have declined materially relative to general market prices; and
- (e) for loans exceeding €3 million or 5% of the *capital resources* of the *firm*, the property valuation must be reviewed by an independent valuer at least every three years.

(2) For the purposes of (1), 'independent valuer' means a person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process.

[Note: BCD Annex VIII Part 2 point 8(b)]

3.4.67 **G** A property will need to be revalued over time to ensure that the original purchase price does not overstate the degree of security provided by the property. Ijara providers should undertake revaluations in the same way as providers of conventional mortgages.

3.4.68 **G** For the purposes of **■ BIPRU 3.4.66 R (1)(a)**, the monitoring of property values should be an inherent part of risk managing and tracking the portfolio. The requirement to monitor property values does not include the physical assessment of each property in the portfolio.

3.4.69 **G** For the purposes of **■ BIPRU 3.4.66 R (1)(d)** and **■ (e)**, the review of a property valuation is more in-depth than the normal monitoring process required by **■ BIPRU 3.4.66 R (1)(a)**. This requirement is likely to include a review of the property value on an individual *exposure* basis. Where an *exposure* is secured by multiple properties, the review can be undertaken at the level of the *exposure*, rather than at the level of each individual property.

- 3.4.70** **G** The review of property values required by ■ BIPRU 3.4.66 R (1)(e) may lead to an amendment of the value assigned to the property under by ■ BIPRU 3.4.80 R.
- 3.4.71** **G** For the purposes of ■ BIPRU 3.4.66 R (2), necessary qualifications need not be professional qualifications but the firm should be able to demonstrate that he or she has the necessary ability and experience to undertake the review.
- 3.4.72** **R** The requirements about documentation referred to in ■ BIPRU 3.4.60 R (4)(c) are that the types of residential real estate accepted by the *firm* and its lending policies in this regard must be clearly documented.
[Note: BCD Annex VIII Part 2 point 8(c)]
- 3.4.73** **R** The requirements about insurance referred to in ■ BIPRU 3.4.60 R (4)(d) are that the *firm* must have procedures to monitor that the property taken as protection is adequately insured against damage.
[Note: BCD Annex VIII Part 2 point 8(d)]
- 3.4.74** **G** For the purposes of ■ BIPRU 3.4.73 R a *firm* should, as a minimum, ensure that it is a requirement of each loan that the property taken as collateral must have adequate buildings insurance at all times, which should be reviewed when any new loan is extended against the property.
- 3.4.75** **G** A *firm* may deal with the risk that insurance on properties taken as protection may be inadequate by taking out insurance at the level of the portfolio.
- 3.4.76** **R** The valuation *rules* referred to in ■ BIPRU 3.4.60 R (5) are set out in ■ BIPRU 3.4.77 R to ■ BIPRU 3.4.80 R.
- 3.4.77** **R** The property must be valued by an independent valuer at or less than the market value. In the *UK* where rigorous criteria for the assessment of the mortgage lending value exist in statutory or regulatory provisions property may instead be valued by an independent valuer at or less than the mortgage lending value.
[Note: BCD Annex VIII Part 3 point 62]
- 3.4.78** **R** Market value means the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value must be documented in a transparent and clear manner.
[Note: BCD Annex VIII Part 3 point 63]
- 3.4.79** **R** Mortgage lending value means the value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local

market conditions, the current use and alternative appropriate uses of the property. Speculative elements must not be taken into account in the assessment of the mortgage lending value. The mortgage lending value must be documented in a transparent and clear manner.

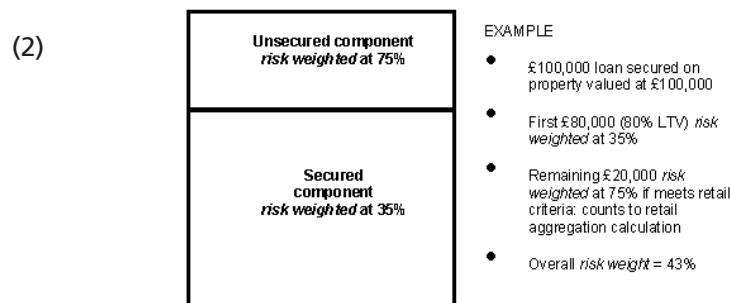
[Note: BCD Annex VIII Part 3 point 64]

3.4.80 **R** The value of the collateral must be the market value or mortgage lending value reduced as appropriate to reflect the results of the monitoring required under **■ BIPRU 3.4.60 R (4)(b)** and **■ BIPRU 3.4.66 R** and to take account of any prior claims on the property.

[Note: BCD Annex VIII Part 3 point 65]

3.4.81 **R** A firm may not treat an exposure as fully and completely secured by residential property located in the *United Kingdom* for the purpose of **■ BIPRU 3.4.56 R** or **■ BIPRU 3.4.58 R** unless the amount of the exposure or of the secured part of the exposure referred to in **■ BIPRU 3.4.56 R** or **■ BIPRU 3.4.58 R**, as the case may be, is 80% or less of the value of the residential property on which it is secured.

3.4.82 **G** (1) The application of **■ BIPRU 3.4.81 R** may be illustrated by an example. If a firm has a mortgage exposure of £100,000 secured on residential property in the *United Kingdom* that satisfies the criteria listed in **■ BIPRU 3.4.56 R** to **■ BIPRU 3.4.80 R** and the value of that property is £100,000, then £80,000 of that exposure may be treated as fully and completely secured and risk weighted at 35%. The remaining £20,000 may be risk weighted at 75% provided the exposure meets the criteria in **■ BIPRU 3.2.10 R**. The portion risk weighted at 75% should be treated as a retail exposure for the purposes of the aggregation calculations specified in **■ BIPRU 3.2.10 R (3)**. A diagrammatic illustration of this example is in (2).



(3) The same approach applies to exposures described in **■ BIPRU 3.4.58 R**. On initiation a 35% risk weight should be applied to the first 80% of the principal/"purchase price" outstanding, with a 75% risk weight being applied to the remainder of the principal (assuming that the exposure meets the requirements in **■ BIPRU 3.2** to be treated as a retail exposure).

3.4.83 **R** [deleted]

- 3.4.84** **R** For the purposes of ■ BIPRU 3.4.56 R or ■ BIPRU 3.4.58 R, a *firm* may only treat an *exposure* as fully and completely secured by residential property situated in the territory of a *third-country competent authority* that is listed as equivalent for credit risk in ■ BIPRU 8 Annex 6 R if it would be treated as fully and completely secured under the applicable requirements of that *third-country competent authority* (including any applicable loan-to-value ceiling).
- 3.4.85** **R** For the purposes of ■ BIPRU 3.4.56 R or ■ BIPRU 3.4.58 R, where the residential property in question is situated in the territory of a *third-country competent authority* that is not listed as equivalent for credit risk in ■ BIPRU 8 Annex 3 R:
- (1) a *firm* must not treat an *exposure* as fully and completely secured by the residential property in question unless the value of the property exceeds the *exposures* by a substantial margin, which must be at least 20%;
- (2) the *firm* must apply a *risk weight* of 50% to the *exposure*.
- 3.4.86** **G** For the purposes of ■ BIPRU 3.4.85 R (1) and in order to satisfy itself that an *exposure* is fully and completely secured by the relevant property, a *firm* should make its own assessment of the appropriate margin in each case, using its knowledge of the market in the relevant country and of its own portfolio.
- 3.4.87** **G** If a *firm* has more than one *exposure* secured on the same property they should be aggregated and treated as if they were a single *exposure* secured on the property for the purposes of ■ BIPRU 3.4.56 R and ■ BIPRU 3.4.58 R and ■ BIPRU 3.4.81 R and ■ BIPRU 3.4.84 R.
- 3.4.88** **G** If an *exposure* is secured on property that is used in part for residential purposes in accordance with ■ BIPRU 3.4.56 R and partly for commercial purposes (such as a farm, public house, guest house or shop) it may be treated as secured by residential real estate if the *firm* can demonstrate that the property's main use is, or will be, residential and that the value of the property is not significantly affected by its commercial use.
- Exposures secured by mortgages on commercial real estate**.....
- 3.4.89** **R** *Exposures* or any part of an *exposure* secured by mortgages on offices or other commercial premises which cannot properly be considered to fall within any other *standardised credit risk exposure class* or to qualify for a lower *risk weight* under ■ BIPRU 3 must be assigned a *risk weight* of 100%.
[Note: BCD Annex VI Part 1 point 51]
- 3.4.90** **R** [deleted]
- 3.4.91** **R** [deleted]
- 3.4.92** **R** [deleted]

3.4.93	R	[deleted]
3.4.94	R	[deleted]
Past due items		
3.4.95	G	■ BIPRU 3.4.96 R to ■ BIPRU 3.4.101 R set out the treatment to be accorded to past due items.
3.4.96	R	Without prejudice to the provisions contained in ■ BIPRU 3.4.97 R to ■ BIPRU 3.4.101 R, the unsecured part of any item that is past due for more than 90 days (irrespective of the amount of that item or of the unsecured portion of that item) must be assigned a <i>risk weight</i> of: <ol style="list-style-type: none"> (1) 150% if value adjustments are less than 20% of the unsecured part of the <i>exposure</i> gross of value adjustments; and (2) 100% if value adjustments are no less than 20% of the unsecured part of the <i>exposure</i> gross of value adjustments. <p>[Note: BCD Annex VI Part 1 point 61]</p>
3.4.97	R	For the purpose of defining the secured portion of the past due item, eligible collateral and guarantees must be those eligible for <i>credit risk mitigation</i> purposes under ■ BIPRU 5. [Note: BCD Annex VI Part 1 point 62]
3.4.98	G	For the purposes of ■ BIPRU 3.4.97 R, the secured portion of a past due item is dealt with under ■ BIPRU 5 (Credit risk mitigation). A <i>firm</i> may treat the secured portion of an <i>exposure</i> covered by a mortgage indemnity product that meets the relevant CRM eligibility criteria as secured for the purposes of ■ BIPRU 3.4.97 R. The <i>risk weight</i> to be applied to the secured portion is determined under ■ BIPRU 5.7.21 R to ■ BIPRU 5.7.24 R. The <i>risk weight</i> of the unsecured portion is determined in accordance with ■ BIPRU 3.4.96 R.
3.4.99	R	<i>Exposures</i> indicated in ■ BIPRU 3.4.56 R to ■ BIPRU 3.4.61R (<i>Exposures</i> secured by mortgages on residential property) must be assigned a <i>risk weight</i> of 100% net of value adjustments if they are past due for more than 90 days. If value adjustments are no less than 20% of the <i>exposure</i> gross of value adjustments, the <i>risk weight</i> to be assigned to the remainder of the <i>exposure</i> is 50%. [Note: BCD Annex VI Part 1 point 64]
3.4.100	G	The application of ■ BIPRU 3.4.96 R and ■ BIPRU 3.4.99 R may be illustrated on the basis of a £110,000 loan on a property valued at £100,000, where £80,000 of the loan is secured and £30,000 of the <i>exposure</i> is unsecured and provisions of £20,000 are taken: <ol style="list-style-type: none"> (1) Option 1 (application of ■ BIPRU 3.4.96 R): <ol style="list-style-type: none"> (a) provision of £20,000 taken on £80,000 secured <i>exposure</i>;

- (b) provision exceeds 20%, so the *firm* should *risk weight* the remaining £60,000 secured *exposure* at 50%;
 - (c) the *risk weight* to be applied to the unsecured *exposure* of £30,000 is 150%;
 - (d) the average *risk weight* to be assigned to the net *exposure* of £90,000 is 83%.
- (2) Option 2 (application of ■ BIPRU 3.4.99 R):
- (a) provision of £20,000 taken on £30,000 unsecured *exposure*;

- (b) provision exceeds 20%, so the *firm* should *risk weight* the remaining £10,000 unsecured *exposure* at 100%;
- (c) the *risk weight* to be applied to the secured *exposure* of £80,000 is 100%;
- (d) the average *risk weight* to be assigned to the net *exposure* of £90,000 is 100%.

3.4.101 **R** Exposures indicated in ■ BIPRU 3.4.89 R (Exposures secured by mortgages on commercial real estate) must be assigned a *risk weight* of 100% if they are past due for more than 90 days.
 [Note: BCD Annex VI Part 1 point 65]

3.4.102 **R** Non past due items to be assigned a 150% *risk weight* under ■ BIPRU 3.4 and for which value adjustments have been established may be assigned a *risk weight* of:

- (1) 100% if value adjustments are no less than 20% of the *exposure* value gross of value adjustments; and
- (2) 50%, if value adjustments are no less than 50% of the *exposure* value gross of value adjustments.

[Note: BCD Annex VI Part 1 point 67]

Items belonging to regulatory high-risk categories

3.4.103 **R** ■ BIPRU 3.4.104 R sets out the treatment to be accorded to items belonging to regulatory high-risk categories.

3.4.104 **R** Exposures listed in ■ BIPRU 3 Annex 3 R must be assigned a *risk weight* of 150%.
 [Note: BCD Annex VI Part 1 point 66]

3.4.105 **G** The *exposures* listed in ■ BIPRU 3 Annex 3 R are in the view of the *appropriate regulator* associated with particularly high risk.
 [Note: BCD Annex VI Part 1 point 66]

Exposures in the form of covered bonds

3.4.106 **R** ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.110 R set out the treatment to be accorded to *exposures* in the form of *covered bonds*.

3.4.107 **R**

- (1) *Covered bonds* means covered bonds as defined in the definition in the *Glossary* and collateralised by any of the following eligible assets:
 - (a) *exposures* to or guaranteed by the UK central government, the Bank of England, *public sector entities*, regional governments and local authorities in the UK;

- (b) (i) exposures to or guaranteed by non-UK central governments, non-UK central banks, multilateral development banks, international organisations that qualify for the *credit quality step 1*;
- (ii) exposures to or guaranteed by non-UK public sector entities, non-UK regional governments and non-UK local authorities that are *risk weighted* as exposures to institutions or central governments and central banks according to ■ BIPRU 3.4.23 R, ■ BIPRU 3.4.24 R, ■ BIPRU 3.4.10 R or ■ BIPRU 3.4.16 G respectively and that qualify for the *credit quality step 1*; and
- (iii) exposures in the sense of this point (b) that qualify as a minimum for the *credit quality step 2*, provided that they do not exceed 20% of the nominal amount of outstanding covered bonds of issuing institutions;
- (c) exposures to institutions that qualify for the *credit quality step 1* but so that:
- (i) the total exposure of this kind must not exceed 15% of the nominal amount of the outstanding covered bonds of the issuing credit institution;
- (ii) exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by real estate to the holders of covered bonds must not be comprised by the 15% limit; and
- (iii) exposures to institutions in the EEA with a maturity not exceeding 100 days are not comprised by the step 1 requirement but those institutions must as a minimum qualify for *credit quality step 2*;
- (d) [deleted]
- (e) (i) [deleted]
- (ii) [deleted]
- (iii) a firm may recognise loans secured by commercial real estate as eligible where the loan to value ratio of 60% is exceeded up to a maximum level of 70% if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10%, and the bondholders' claim meets the legal certainty requirements set out in ■ BIPRU 3 and ■ BIPRU 5; the bondholders' claim must take priority over all other claims on the collateral;
- (f) loans secured by ships where only liens that are combined with any prior liens within 60% of the value of the pledged ship.
- (2) [deleted]
- (3) For the purposes of ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.110 R "collateralised" includes situations where the assets described in subpoints (1)(a) to (1)(f) are exclusively dedicated in law to the protection of the bond-holders against losses.
- (4) [deleted]
- (4A) [deleted]

(5) [deleted]

[Note: BCD Annex VI Part 1 point 68]

3.4.108 **R** A firm must for real estate collateralising covered bonds meet the minimum requirements set out in ■ BIPRU 3.4.64 R to ■ BIPRU 3.4.73 R and the valuation rules set out in ■ BIPRU 3.4.77 R to ■ BIPRU 3.4.80 R.

[Note: BCD Annex VI Part 1 point 69]

3.4.109 **R** Notwithstanding ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.108 R, covered bonds meeting the definition in the Glossary and issued before 31 December 2007 are also eligible for the preferential treatment until their maturity.

[Note: BCD Annex VI Part 1 point 70]

3.4.110 **R** Covered bonds must be assigned a risk weight on the basis of the risk weight assigned to senior unsecured exposures to the credit institution which issues them. The following correspondence between risk weights applies:

- (1) if the exposures to the institution are assigned a risk weight of 20%, the covered bond must be assigned a risk weight of 10%;
- (2) if the exposures to the institution are assigned a risk weight of 50%, the covered bond must be assigned a risk weight of 20%;
- (3) if the exposures to the institution are assigned a risk weight of 100%, the covered bond must be assigned a risk weight of 50%; and
- (4) if the exposures to the institution are assigned a risk weight of 150%, the covered bond must be assigned a risk weight of 100%.

[Note: BCD Annex VI Part 1 point 71]

Items representing securitisation positions

3.4.111 **R** Risk weighted exposure amounts for securitisation positions must be determined in accordance with ■ BIPRU 9.

[Note: BCD Annex VI Part 1 point 72]

Exposures to institutions and corporates with a short-term credit assessment

3.4.112 **R** Exposures to institutions where ■ BIPRU 3.4.34 R to ■ BIPRU 3.4.39 R apply, and exposures to corporates for which a short-term credit assessment by a nominated ECAI is available must be assigned a risk weight according to the table in ■ BIPRU 3.4.113 R in accordance with the mapping by the appropriate regulator in accordance with the Capital Requirements Regulations 2006 of the credit assessments of eligible ECAs to six steps in a credit quality assessment scale.

[Note: BCD Annex VI Part 1 point 73]

Table: Exposures to institutions where BIPRU 3.4.34 R to BIPRU 3.4.39 R apply, and exposures to corporates for which a short-term credit assessment by a nominated ECAI is available

3.4.113

R

This table belongs to ■ BIPRU 3.4.112 R.

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	150%	150%	150%

Exposures in the form of collective investment undertakings (CIUs)

3.4.114

R

■ BIPRU 3.4.115 R to ■ BIPRU 3.4.125 R set out the treatment to be accorded to exposures in the form of CIUs.

3.4.115

R

Without prejudice to ■ BIPRU 3.4.116 R to ■ BIPRU 3.4.125 R, exposures in CIUs must be assigned a risk weight of 100%.

[Note: BCD Annex VI Part 1 point 74]

3.4.116

R

Exposures in the form of CIUs for which a credit assessment by a nominated ECAI is available must be assigned a risk weight according to the table in ■ BIPRU 3.4.117 R in accordance with the assignment by the appropriate regulator in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of eligible ECAs to six steps in a credit quality assessment scale.

[Note: BCD Annex VI Part 1 point 75]

3.4.117

R

Table: Exposures in the form of CIUs for which a credit assessment by a nominated ECAI is available

This table belongs to ■ BIPRU 3.4.116 R.

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

3.4.118

R

Where a firm considers that a position in a CIU is associated with particularly high risks it must assign that position a risk weight of 150%.

[Note: BCD Annex VI Part 1 point 76]

3.4.119

G

A firm should consider a CIU as being high risk where there is no external credit assessment from an eligible ECAI and where the CIU has specific features (such as high levels of leverage or lack of transparency) that prevent it from meeting the eligibility criteria laid out in ■ BIPRU 3.4.121 R.

3.4.120

G

Other examples of high risk CIUs are: one in which a substantial element of the CIU's property is made up of items that would attract a risk weight of over 100%; or one whose mandate (as referred to in ■ BIPRU 3.4.124 R) would permit it to invest in a substantial amount of such items.

3.4.121 **R** Where ■ BIPRU 3.4.116 R does not apply, a *firm* may determine the *risk weight* for a *CIU* as set out in ■ BIPRU 3.4.123 R to ■ BIPRU 3.4.125 R, if the following eligibility criteria are met:

- (1) one of the following conditions is satisfied:
 - (a) the *CIU* is managed by a company which is subject to supervision in the *UK*; or
 - (b) the following conditions are satisfied:
 - (i) the *CIU* is managed by a company which is subject to supervision that is equivalent to that laid down in *UK* law; and
 - (ii) cooperation between *competent authorities* and *third country competent authorities* is sufficiently ensured; and
- (2) the *CIU*'s prospectus or equivalent document includes:
 - (a) the categories of assets in which the *CIU* is authorised to invest; and
 - (b) if investment limits apply, the relative limits and the methodologies to calculate them; and
- (3) the business of the *CIU* is reported on at least an annual basis to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

[Note: BCD Annex VI Part 1 point 77]

3.4.122 **R** [deleted]

3.4.123 **R** Where a *firm* is aware of the underlying *exposures* of a *CIU*, it may look through to those underlying *exposures* in order to calculate an average *risk weight* for the *CIU* in accordance with the *standardised approach*.

[Note: BCD Annex VI Part 1 point 79]

3.4.124 **R** Where a *firm* is not aware of the underlying *exposures* of a *CIU*, it may calculate an average *risk weight* for the *CIU* in accordance with the *standardised approach* subject to the following rules: it will be assumed that the *CIU* first invests, to the maximum extent allowed under its mandate, in the *standardised credit risk exposure classes* attracting the highest capital requirement, and then continues making investments in descending order until the maximum total investment limit is reached.

[Note: BCD Annex VI Part 1 point 80]

3.4.125 **R** A *firm* may rely on a third party to calculate and report, in accordance with the methods set out in ■ BIPRU 3.4.123 R to ■ BIPRU 3.4.124 R, a *risk weight* for the *CIU* provided that the correctness of the calculation and report is adequately ensured.

[Note: BCD Annex VI Part 1 point 81]

Other items

- 3.4.126 **R** ■ BIPRU 3.4.127 R to ■ BIPRU 3.4.133 R set out the treatment to be accorded to other items as referred to in ■ BIPRU 3.2.9 R (16).

Treatment

- 3.4.127 **R** Tangible assets within the meaning of Article 4(10) of the *Bank Accounts Directive* must be assigned a *risk weight* of 100%.
[Note: BCD Annex VI Part 1 point 82]
- 3.4.128 **R** Prepayments and accrued income for which a *firm* is unable to determine the counterparty in accordance with the *Bank Accounts Directive*, must be assigned a *risk weight* of 100%.
[Note: BCD Annex VI Part 1 point 83]
- 3.4.129 **R** Cash items in the process of collection must be assigned a 20% *risk weight*. Cash in hand and equivalent cash items must be assigned a 0% *risk weight*.
[Note: BCD Annex VI Part 1 point 84]
- 3.4.130 **R** Holdings of equity and other participations except where deducted from *capital resources* must be assigned a *risk weight* of at least 100%.
[Note: BCD Annex VI Part 1 point 86]
- 3.4.131 **R** Gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities must be assigned a 0% *risk weight*.
[Note: BCD Annex VI Part 1 point 87]
- 3.4.132 **R** In the case of asset sale and *repurchase agreements* and outright forward purchases, the *risk weight* must be that assigned to the assets in question and not to the counterparties to the transactions.
[Note: BCD Annex VI Part 1 point 88]
- 3.4.133 **R** Where a *firm* provides credit protection for a number of *exposures* under terms that the *n*th default among the *exposures* triggers payment and that this credit event terminates the contract, and where the product has an external credit assessment from an *eligible ECAI* the *risk weights* prescribed in ■ BIPRU 9 must be assigned. If the product is not rated by an *eligible ECAI*, the *risk weights* of the *exposures* included in the basket must be aggregated, excluding *n-1 exposures*, up to a maximum of 1250% and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the *risk weighted asset amount*. The *n-1 exposures* to be excluded from the aggregation must be determined on the basis that they include those *exposures* each of which produces a lower *risk weighted exposure amount* than the *risk weighted exposure amount* of any of the *exposures* included in the aggregation.
[Note: BCD Annex VI Part 1 point 89]

3.4.134 **R** The *exposure* value for leases must be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. an option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in ■ BIPRU 5.7.1 R (Eligibility), regarding the eligibility of protection providers as well as the minimum requirements for recognising other types of guarantees provided in ■ BIPRU 5.7.6 R (Minimum requirements: General) to ■ BIPRU 5.7.12 R (Additional requirements for guarantees) must also be included in the minimum lease payments. These *exposures* must be assigned to the relevant *exposure* class in accordance with ■ BIPRU 3.2.9 R, ■ BIPRU 3.2.10 R, ■ BIPRU 3.2.11 R, ■ BIPRU 3.2.12 R, ■ BIPRU 3.2.13 R and ■ BIPRU 3.2.14 G. When the *exposure* is a residual value of leased properties, the *risk weighted exposure amounts* must be calculated as follows:

$1/t * 100\% * \textit{exposure value};$

where t is the greater of 1 and the nearest number of whole years of the lease term remaining.

[Note: BCD Annex VI Part 1, point 90]



3.5 Simplified method of calculating risk weights

3.5.1 G This section (■ BIPRU 3.5) sets out a simplified approach to calculating *risk weights*. This approach is only relevant to an *exposure* class for which *risk weights* are determined by the ratings of a *nominated ECAI* or an export credit agency. For other *exposure* classes a *firm* should use the normal approach under the *standardised approach*.

3.5.2 G The approach in this section is only likely to be relevant for a *limited licence firm* or a *limited activity firm* that has only incidental credit *exposures* and for whom it would be prohibitively costly to establish the systems needed to include the credit assessments of *ECAIs* and export credit agencies in its regulatory capital calculations. However the approach may be used by other *firms* if appropriate. A *firm* should notify the *appropriate regulator* if it adopts the approach in this section.

3.5.3 G Rather than *risk weighting exposures* individually, a *firm* eligible to apply the simplified approach should apply a single *risk weight* to all *exposures* in each *exposure* class. The simplified *risk weight* for *exposures* in a particular class will be the *risk weighting* for unrated entities for each *exposure* class in which the external credit assessments influence *risk weights*.

3.5.4 G The table in ■ BIPRU 3.5.5 G has a summary of the *risk weights* that a *firm* should use if it uses the simplified method of calculating *risk weights* referred to in ■ BIPRU 3.5.1 G.

3.5.5 G Table : Simplified method of calculating risk weights

This table belongs to ■ BIPRU 3.5.4 G.

Exposure class	Exposure sub-class	Risk weights	Comments
Central government	<i>Exposures to United Kingdom government or Bank of England in sterling</i>	0%	

Exposure class	Exposure sub-class	Risk weights	Comments
Regional/local governments	<i>Exposures to central governments or central banks of certain countries outside the UK in currency of that country</i>	See next column	The <i>risk weight</i> is whatever it is under local law. See BIPRU 3.4.6 R for precise details.
	Other <i>exposures</i>	100%	
	<i>Exposures to the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly in sterling</i>	0%	
	<i>Exposures to local or regional governments of certain countries outside the UK in currency of that country</i>	0%	See BIPRU 3.4.19 R for details of type of local/regional government covered. See Note.
	<i>Exposures to United Kingdom local/regional government in sterling if the exposure has original effective maturity of 3 months or less</i>	20%	
PSE	<i>Exposures to local or regional governments of countries outside the UK in currency of that country if the exposure has original effective maturity of 3 months or less</i>	20%	See Note.
	Other <i>exposures</i>	100%	
	<i>Exposures to a PSE of the United Kingdom if that PSE is guaranteed by central government and if the exposure is in sterling.</i>	0%	BIPRU 3.4.24 R describes the <i>United Kingdom PSEs</i> covered.

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to PSE of a country outside the UK if that PSE is guaranteed by the country's central government and if the exposure is in currency of that country.</i>	0%	See BIPRU 3.4.26 R and Note.
	<i>Exposures to a PSE of the United Kingdom in sterling if the exposure has original effective maturity of 3 months or less</i>	20%	
	<i>Exposures to PSE of a country outside the UK in currency of that country if the exposure has original effective maturity of 3 months or less</i>	20%	See Note.
	<i>Other exposures</i>	100%	
<i>Multilateral development banks</i>	<i>Exposures to multilateral development banks listed in paragraph (1) of the Glossary definition</i>	0%	Simplified approach does not apply. Normal rules apply.
	<i>Other exposures</i>	Various	Treated as an institution
<i>EU, The International Monetary Fund and the Bank for International Settlements</i>		0%	Simplified approach does not apply. Normal rules apply.
<i>Institutions</i>	<i>Exposures to United Kingdom institution in sterling with original effective maturity of three months or less</i>	20%	

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to institution with a head office in a country outside the UK in the currency of that country with original effective maturity of three months or less</i>	20%	See Note.
	<i>Exposures to United Kingdom institution in sterling with original effective maturity of over three months</i>	50%	
	<i>Exposures to institution with a head office in a country outside the UK in the currency of that country with original effective maturity of over three months</i>	50%	See Note.
	<i>Other exposures</i>	100%	
<i>Corporates</i>		100%	
<i>Retail exposures</i>		75%	Simplified approach does not apply. Normal rules apply.
	Mortgages on residential or commercial property	Various	Simplified approach does not apply. Normal rules apply.
	Past due items	Various	Simplified approach does not apply. Normal rules apply.
	High risk items	150%	Simplified approach does not apply. Normal rules apply.
	<i>Covered bonds</i>	Various	<i>Risk weights are based on the risk weight of issuer as described in BIPRU 3.4.110 R. The risk weight of the issuer for this purpose should</i>

Exposure class	Exposure sub-class	Risk weights	Comments
<i>Securitisation exposures</i>		Generally 1250%. May look through to underlying exposures if BIPRU 9 allows.	be calculated under the simplified approach. Use the BIPRU 9 rules for unrated exposures under the <i>standardised approach</i>
Short term exposures with rating			See BIPRU 3.4.112 R. Not applicable as uses <i>ECAI</i> ratings.
CIUs	May look through to underlying under BIPRU 3.4.123 R	Various	Simplified approach does not apply. Normal rules apply. May use simplified approach to underlying if simplified approach applies to underlying.
	May use average risk weight under BIPRU 3.4.124 R	Various	Simplified approach does not apply. Normal rules apply. May use simplified approach to underlyings if simplified approach applies to underlying.
	High risk under BIPRU 3.4.118 R	150%	Simplified approach does not apply. Normal rules apply.
Other items under BIPRU 3.2.9 R (16)	Others	100%	
		Various	Simplified approach does not apply. Normal rules apply.

Note: The *risk weight* should not be lower than the *risk weight* that applies for national currency exposures of the central government of the third country in question under BIPRU 3.5. That means that this *risk weight* only applies if the third country is one of those to which BIPRU 3.4.6 R (Preferential *risk weight* for exposures of the central government of countries outside the UK that apply equivalent prudential standards) applies.

3.5.6



If an exposure is guaranteed and if under ■ BIPRU 5 the firm may treat the exposure as being to the guarantor, the simplified approach may be used for the guarantor. The key provisions are ■ BIPRU 5.7.23 R to ■ BIPRU 5.7.25 R.

3.5.7 **G** If an *exposure* is collateralised and if under **■ BIPRU 5** the *firm* may recognise the collateral, the simplified approach may be used to determine the *risk weight* to be applied to the collateralised *exposure*. The key provisions are **■ BIPRU 5.4.18 R** to **■ BIPRU 5.4.21 R**.

3.5.8 **R** If a *firm* does not nominate one or more *eligible ECAs* as referred to in **■ BIPRU 3.6.4 R** the *firm* must not use the *financial collateral comprehensive method*.



3.6 Use of rating agencies' credit assessments for the determination of risk weights under the standardised approach to credit risk

3.6.1 **R** The use of *ECAI* credit assessments for the calculation of a *firm's risk weighted exposure amounts* must be consistent and in accordance with **■ BIPRU 3.6**. Credit assessments must not be used selectively.
 [Note: *BCD* Article 83(1)]

3.6.2 **R** Where the *appropriate regulator's* recognition of an *ECAI* is not limited to its solicited credit assessments, a *firm* may use an unsolicited credit assessment of an *eligible ECAI* for the calculation of a *firm's risk weighted exposure amounts*.
 [Note: *BCD* Article 83(2)]

3.6.3 **G** The *appropriate regulator's* recognition of an *ECAI* may be limited to its solicited credit assessments. Where this is the case a *firm* should not use unsolicited assessments. The *appropriate regulator* may indicate that the unsolicited ratings of an *eligible ECAI* are not to be used for the purposes of **■ BIPRU 3** if those assessments are considered to be inferior in quality to the general quality of solicited assessments or if it considers that the *ECAI's* strategy in relation to the issuing of unsolicited assessments is founded in the placing of undue pressure on the rated entity to pay for a rating.

Treatment

3.6.4 **R** A *firm* may nominate one or more *eligible ECAs* to be used for the determination of *risk weights* to be assigned to asset and off-balance sheet items.
 [Note: *BCD* Annex VI Part 3 point 1]

3.6.5 **R** A *firm* which decides to use the credit assessments produced by an *eligible ECAI* for a certain class of items must use those credit assessments consistently for all *exposures* belonging to that class.
 [Note: *BCD* Annex VI Part 3 point 2]

- 3.6.6** **R** A *firm* which decides to use the credit assessments produced by an *eligible ECAI* must use them in a continuous and consistent way over time.
[Note: BCD Annex VI Part 3 point 3]
- 3.6.7** **R** A *firm* can only use *ECAs*' credit assessments that take into account all amounts both in principal and in interest owed to it.
[Note: BCD Annex VI Part 3 point 4]
- 3.6.8** **R** If only one credit assessment is available from a *nominated ECAI* for a rated item, that credit assessment must be used to determine the *risk weight* for that item.
[Note: BCD Annex VI Part 3 point 5]
- 3.6.9** **R** If two credit assessments are available from *nominated ECAs* and the two correspond to different *risk weights* for a rated item, the higher *risk weight* must be applied.
[Note: BCD Annex VI Part 3 point 6]
- 3.6.10** **R** If more than two credit assessments are available from *nominated ECAs* for a rated item, the two assessments generating the two lowest *risk weights* must be referred to. If the two lowest *risk weights* are different, the higher *risk weight* must be assigned. If the two lowest *risk weights* are the same, that *risk weight* must be assigned.
[Note: BCD Annex VI Part 3 point 7]
- 3.6.11** **R**
- (1) If a *firm* has decided to make use of the credit assessments of export credit agencies, when *risk weighting exposures* to central governments or *central banks*, if two or more credit assessments are available to a *firm* from export credit agencies or if credit assessments are available to a *firm* from both *nominated ECAs* and export credit agencies, the *firm* must adopt the approach in this *rule*.
 - (2) If two credit assessments are available and correspond to different *risk weights* for a rated item, the higher *risk weight* must be applied.
 - (3) If more than two credit assessments are available for a rated item, the assessments generating the two lowest *risk weights* must be referred to:
 - (a) if the two lowest *risk weights* are the same, that *risk weight* must be applied; or
 - (b) if the two lowest *risk weights* are different, the higher of the two must be applied.
 - (4) If a *firm* does not for the purposes of ■ BIPRU 3 make any use of the consensus risk scores referred to in ■ BIPRU 3.4.7 R (1) it may treat those scores as not being available to it for the purpose of this *rule*. Likewise, if a *firm* does not for the purposes of ■ BIPRU 3 make any use of the credit assessments of a particular export credit agency as

referred to in ■ BIPRU 3.4.7 R (2) it may treat those assessments as not being available to it for the purpose of this *rule*.

Issuer and issue credit assessment

3.6.12 **R** Where a credit assessment exists for a specific issuing program or facility to which the item constituting the *exposure* belongs, this credit assessment must be used to determine the *risk weight* to be assigned to that item.

[Note: BCD Annex VI Part 3 point 8]

3.6.13 **R** Where no directly applicable credit assessment exists for a certain item, but a credit assessment exists for a specific issuing program or facility to which the item constituting the *exposure* does not belong or a general credit assessment exists for the issuer, then that credit assessment must be used if it produces a higher *risk weight* than would otherwise be the case or if it produces a lower *risk weight* and the *exposure* in question ranks *pari passu* or senior in all respects to the specific issuing program or facility or to senior unsecured *exposures* of that issuer as relevant.

[Note: BCD Annex VI Part 3 point 9]

3.6.14 **R** ■ BIPRU 3.6.12 R and ■ BIPRU 3.6.13 R are not to prevent the application of ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.110 R (Exposures in the form of covered bonds).

[Note:BCD Annex VI Part 3 point 10]

3.6.15 **R** Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

[Note: BCD Annex VI Part 3 point 11]

Long-term and short-term credit assessments

3.6.16 **R** Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting *exposures* to *institutions* and *corporates*.

[Note: BCD Annex VI Part 3 point 12]

3.6.17 **R** Any short-term credit assessment may only apply to the item the short-term credit assessment refers to, and it must not be used to derive *risk weights* for any other item.

[Note: BCD Annex VI Part 3 point 13]

3.6.18 **R** Notwithstanding ■ BIPRU 3.6.17 R, if a short-term rated facility is assigned a 150% *risk weight*, then all unrated unsecured *exposures* on that obligor whether short-term or long-term must also be assigned a 150% *risk weight*.

[Note: BCD Annex VI Part 3 point 14]

3.6.19 **R** Notwithstanding ■ BIPRU 3.6.17 R, if a short-term rated facility is assigned a 50% *risk weight*, no unrated short-term *exposure* may be assigned a *risk weight* lower than 100%.

[Note: BCD Annex VI Part 3 point 15]

Domestic and foreign currency items.....

3.6.20 **R** A credit assessment that refers to an item denominated in the obligor's domestic currency cannot be used to derive a *risk weight* for another *exposure* on that same obligor that is denominated in a foreign currency.

[Note: BCD Annex VI Part 3 point 16]

3.6.21 **R** Notwithstanding ■ BIPRU 3.6.20 R, when an *exposure* arises through a *firm's* participation in a loan that has been extended by a *multilateral development bank* whose preferred creditor status is recognised in the market, the credit assessment on the obligors' domestic currency item may be used for *risk weighting* purposes.

[Note: BCD Annex VI Part 3 point 17]

3.7 Classification of off-balance-sheet items

- 3.7.1** **R** In accordance with ■ BIPRU 3.2.1 R (2) and ■ BIPRU 3.2.2 R, a *firm* must:
- (1) assign an off-balance sheet item listed in the table in ■ BIPRU 3.7.2 R to the risk category indicated in column 1 of that table; and
 - (2) determine the *exposure* value of that item as the percentage of its value for the appropriate risk category as set out in column 3 of the table in ■ BIPRU 3.7.2 R.

Table: Classification of off-balance-sheet items

3.7.2 **R** This table belongs to ■ BIPRU 3.7.1 R

[Note: BCD Annex II]

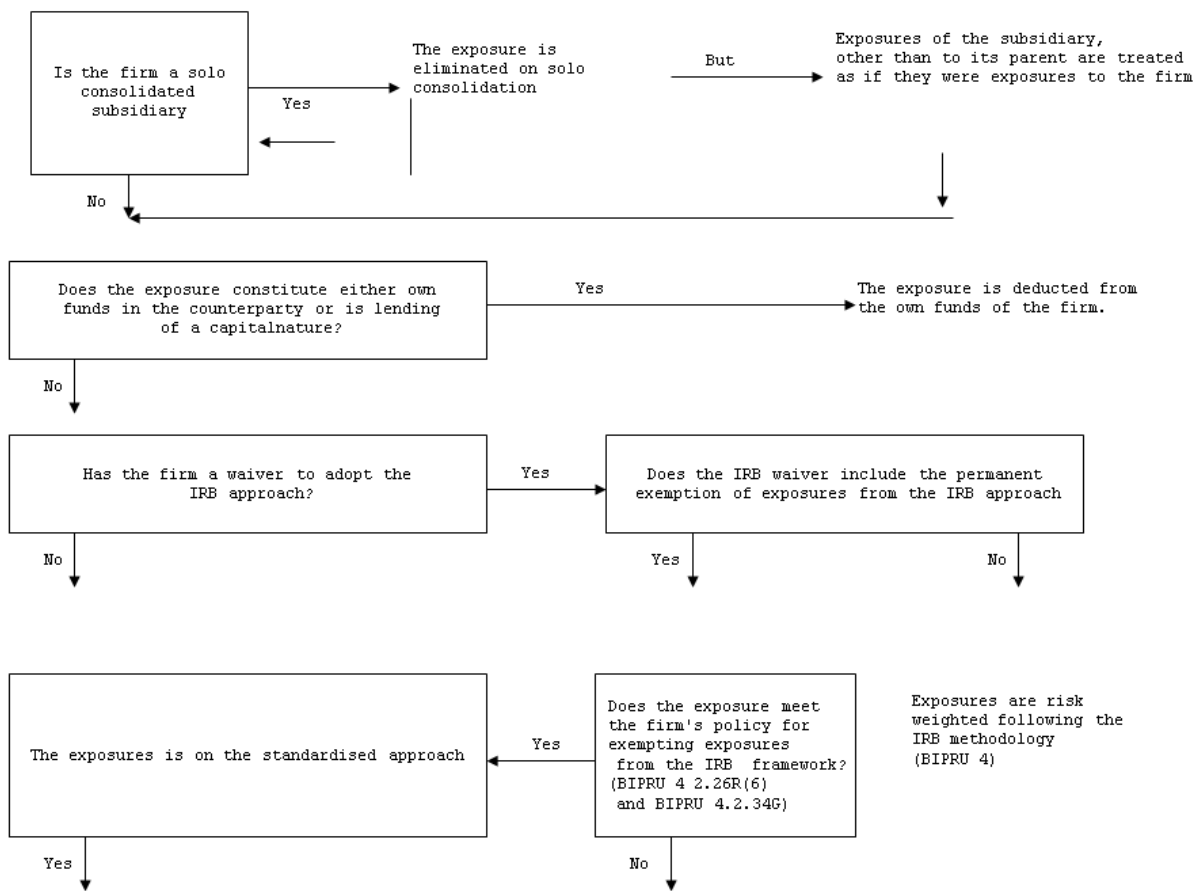
Category	Item	Percentage
Full risk	Guarantees having the character of credit substitutes	100%
	Credit derivatives	
	Acceptances	
	Endorsements on bills not bearing the name of another <i>credit institution</i>	
	Transactions with recourse	
	Irrevocable standby letters of credit having the character of credit substitutes	
	Assets purchased under outright forward purchase agreements	
	Forward deposits	
	The unpaid portion of partly-paid <i>shares</i> and <i>securities</i>	
	Asset sale and repurchase agreements as defined in Article 12(3) and (5) of the <i>Bank Accounts Directive</i>	
Medium risk	Other items also carrying full risk	50%
	Documentary credits issued and confirmed (see also medium/low risk). Warranties and indemnities (including tender, performance, customs and tax	

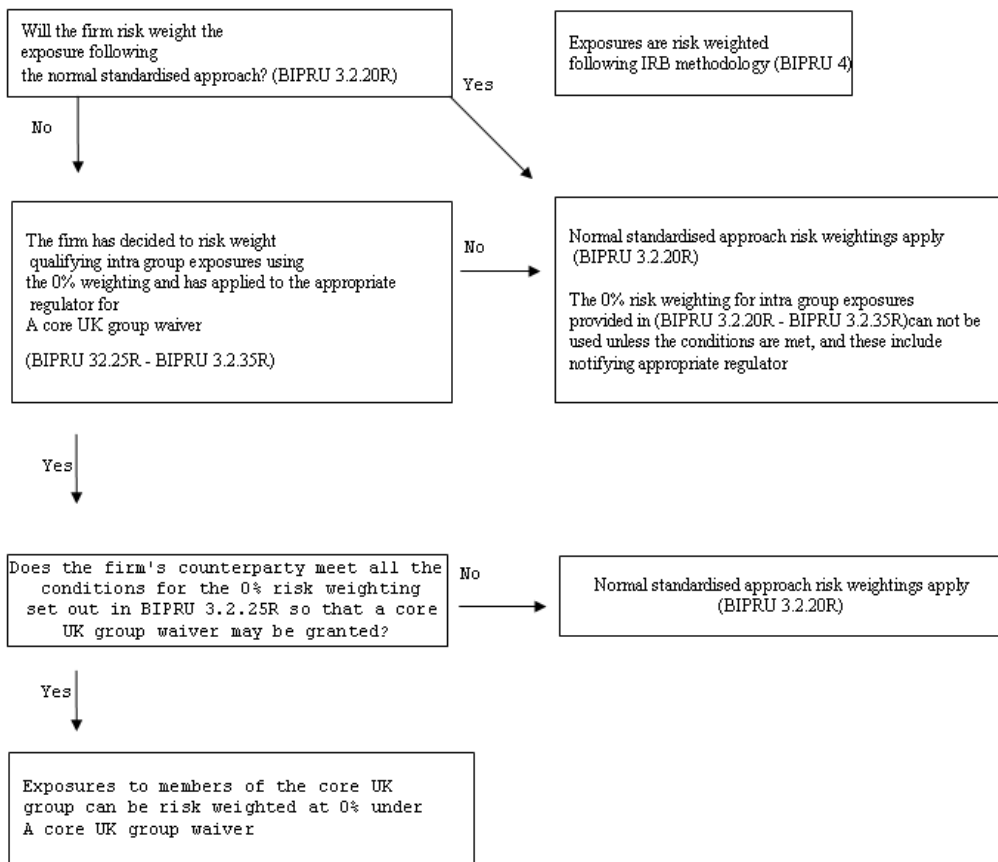
Category	Item	Percentage
Medium/low risk	bonds) and guarantees not having the character of credit substitutes. Irrevocable standby letters of credit not having the character of credit substitutes.	20%
	Undrawn credit facilities (agreements to lend, purchase <i>securities</i> , provide guarantees or acceptance facilities) with an original maturity of more than one year. Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs). Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions.	
Low risk	Undrawn credit facilities (agreements to lend, purchase <i>securities</i> , provide guarantees or acceptance facilities) with an original maturity of up to and including one year which may not be cancelled unconditionally at any time without notice or that do not effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Undrawn credit facilities (agreements to lend, purchase <i>securities</i> , provide guarantees or acceptance facilities) which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Retail credit lines may be considered as unconditionally cancellable if the terms permit the <i>firm</i> to cancel them to the full extent allowable under consumer protection and related legislation.	0%

Guidance on the standardised approach zero risk weighting for intra-group exposures

This flow chart belongs to ■ BIPRU 3.2.25 R - ■ BIPRU 3.2.35 R.

Flowchart - zero risk weighting for intra-group exposures





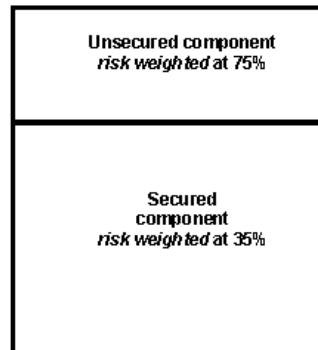
Regional governments and local authorities eligible for the treatment in BIPRU 3.4.15R

- (1) The Scottish Parliament
- (2) National Assembly for Wales
- (3) Northern Ireland Assembly

High risk exposures

- (1) *Exposures arising out of venture capital business (whether or not the firm itself carries on the venture capital business).*
- (2) *Any exposure of the type referred to in BIPRU 3.4.118 R (High risk position in a CIU) that is illiquid and held with a view to long-term sale or realisation.*

Exposures to institutions: Interaction with short-term credit assessments in BIPRU 3.4.40R



EXAMPLE

- £100,000 loan secured on property valued at £100,000
- First £80,000 (80% LTV) *risk weighted at 35%*
- Remaining £20,000 *risk weighted at 75%* if meets retail criteria: counts to retail aggregation calculation
- Overall *risk weight* = 43%

