

Chapter 3

Standardised credit risk

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>(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>	<p>(1) [deleted]</p> <p>(2) [deleted]</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 3.2.25R (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 3.2.25R (1)(e) (Prompt transfer of capital resources):

- (1) in the case of an *undertaking* that is a *firm* the requirement in ■ BIPRU 3.2.25R (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]