

Chapter 4

The IRB approach

4.5 The IRB approach: Specialised lending exposures

Application

4.5.1 **R** ■ BIPRU 4.5 applies with respect to the *exposures* referred to in ■ BIPRU 4.5.3 R.

4.5.2 **R** Except for ■ BIPRU 4.5.1 R and ■ BIPRU 4.5.3 R, ■ BIPRU 4.5 only applies to the extent that a *firm* applies the method in ■ BIPRU 4.5 (slotting).

Definition of specialised lending

4.5.3 **R** Within the *corporate exposure IRB exposure class*, a *firm* must separately identify as *specialised lending exposures*, *exposures* which possess the following characteristics:

- (1) the *exposure* is to an entity which was created specifically to finance and/or operate physical assets;
- (2) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and
- (3) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

[Note: BCD Article 86(6)]

Treatment of specialised lending

4.5.4 **R** If a *firm* is using or is applying to use the *advanced IRB approach* for some or all of its *exposures* in the *sovereign, institution and corporate IRB exposure class*, then *specialised lending exposures* treated under ■ BIPRU 4.5.8 R (Slotting) must be treated as being dealt with under the *advanced IRB approach* for the purposes of the calculations in ■ BIPRU 4.2.30 R and ■ BIPRU 4.2.31 R. If a *firm* is not using or applying to use the *advanced IRB approach* for any of its *exposures* in the *sovereign, institution and corporate IRB exposure class*, in the cases in which it is necessary to distinguish between the *advanced IRB approach* and the *foundation IRB approach*, then *specialised lending exposures* treated under ■ BIPRU 4.5.8 R must be treated as being dealt with under the *foundation IRB approach* for the purposes of the calculations in ■ BIPRU 4.2.30 R and ■ BIPRU 4.2.31 R.

Structure of rating system

- 4.5.5 **R** A firm using the methods set out in ■ BIPRU 4.5.8 R (Slotting) for assigning *risk weights* for *specialised lending exposures* is exempt from the requirement to have an obligor rating scale which reflects exclusively quantification of the risk of obligor *default* for these *exposures*. Notwithstanding ■ BIPRU 4.4.7 R (Seven grades for exposures to sovereigns, institutions and corporates), a firm must have for these *exposures* four grades for non-*defaulted* obligors and one grade for *defaulted* obligors.

[Note: BCD Annex VII Part 4 point 12 and point 21]

Assignment of exposures

- 4.5.6 **R**
- (1) A firm using the methods set out in ■ BIPRU 4.5.8 R (Slotting) for assigning *risk weights* for *specialised lending exposures* must assign each of these *exposures* to a grade in accordance with ■ BIPRU 4 Annex 1 R, taking into account the following factors:
 - (a) financial strength;
 - (b) political and legal environment;
 - (c) transaction and/or asset characteristics;
 - (d) strength of the sponsor and developer including any public private partnership income stream; and
 - (e) security package.
 - (2) A firm must slot *exposures* into the five columns in the tables in ■ BIPRU 4.5.9 R and ■ BIPRU 4.5.13 R as follows:
 - (a) a firm must slot an *exposure* categorised as strong under Annex X into column 1;
 - (b) a firm must slot an *exposure* categorised as good under the Annex X into column 2;
 - (c) a firm must slot an *exposure* categorised as satisfactory under Annex X into column 3;
 - (d) a firm must slot an *exposure* categorised as weak under Annex X into column 4;
 - (e) in accordance with ■ BIPRU 4.5.5 R a firm must slot an *exposure* in *default* into column 5.

[Note: BCD Annex VII Part 1 point 6 (part)]

Calculation of risk-weighted exposure amounts

- 4.5.7 **R** Notwithstanding ■ BIPRU 4.3.5 R (Use of relevant parameters for calculating risk weighted exposure amounts), the calculation of *risk weighted exposure amounts* for credit risk for *specialised lending exposures* may be calculated in accordance with ■ BIPRU 4.5.8 R.

[Note: BCD Article 87(5)]

- 4.5.8 **R** For *specialised lending exposures* in respect of which a firm cannot demonstrate that its *PD* estimates meet the *minimum IRB standards* it must

assign *risk weights* to these *exposures* according to the table in ■ BIPRU 4.5.9 R.

[Note: BCD Annex VII Part 1 point 6 (part)]

4.5.9

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Table: Risk weights for specialised lending

This table belongs to ■ BIPRU 4.5.8 R

Remaining maturity	Category 1 (Strong)	Category 2 (Good)	Category 3 (Satisfactory)	Category 4 (Weak)	Category 5
Less than 2.5 years	50%	70%	115%	250%	0%
Equal or more than 2.5 years	70%	90%	115%	250%	0%

The coverage of each of the categories is set out in BIPRU 4.5.6 R

[Note: BCD Annex VII Part 1 point 6 (part)]

4.5.10

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A *firm* may generally assign preferential *risk weights* of 50% to *exposures* in category 1, and a 70% *risk weight* to *exposures* in category 2 if:

- (1) its *IRB permission* allows this; and
- (2) the *firm's* underwriting characteristics and other risk characteristics are substantially strong for the relevant category.

[Note: BCD Annex VII Part 1 point 6 (part)]

4.5.11

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- (1) If a *firm* applies for an *IRB permission* or for a variation of an *IRB permission* that permits the treatment in ■ BIPRU 4.5.10 R it should demonstrate that its standards exceed those of the slotting criteria provided for in ■ BIPRU 4.5 and result in ratings that are stronger than the benchmarks referred to in (3).
- (2) If a *firm* has an *IRB permission* that permits the treatment in ■ BIPRU 4.5.10 R it should continue to be able to demonstrate the matters in (1) to the *appropriate regulator* if asked.
- (3) Although a *firm* should map its internal ratings to the supervisory categories set out in the table in ■ BIPRU 4.5.9 R using the slotting criteria provided in ■ BIPRU 4.5.6 R, each supervisory category broadly corresponds to a range of external credit assessments of BBB- or better, BB+ or BB, BB- or B+ and B to C- (or their equivalents). The fifth category covers *default*.

Calculation of expected loss amounts

4.5.12

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The *EL* values for *specialised lending exposures* where a *firm* uses the methods set out in ■ BIPRU 4.5.8 R for assigning *risk weights* must be assigned according to the table in ■ BIPRU 4.5.13 R.

[Note: BCD Annex VII Part 1 point 31 (part)]

4.5.13 **R** Table: Expected loss values for specialised lending

This table belongs to ■ BIPRU 4.5.12 R

Remaining maturity	Category 1 (Strong)	Category 2 (Good)	Category 3 (Satisfactory)	Category 4 (Weak)	Category 5
Less than 2.5 years	0%	0.4%	2.8%	8%	50%
Equal or more than 2.5 years	0.4%	0.8%	2.8%	8%	50%

The coverage of each of the categories is set out in BIPRU 4.5.6 R

[Note: BCD Annex VII Part 1 point 31 (part)]

4.5.14 **R** Where a *firm's IRB permission* authorises it generally to assign preferential *risk weights* as outlined in ■ BIPRU 4.5.10 R of 50% to *exposures* in category 1, and 70% to *exposures* in category 2, the *EL* value for *exposures* in category 1 must be 0%, and for *exposures* in category 2 must be 0.4%.

[Note: BCD Annex VII Part 1 point 31 (part)]