

Chapter 5

Credit risk mitigation

5.5 Other funded credit risk mitigation

Deposits with third parties: Eligibility

- 5.5.1 **R** Cash on deposit with, or *cash assimilated instruments* held by, a third party *institution* in a non-custodial arrangement and pledged to a *lending firm* may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 23]

Deposits with third parties: Minimum requirements

- 5.5.2 **R** To be eligible for the treatment set out at **BIPRU 5.5.3 R**, the protection referred to in **BIPRU 5.5.1 R** must satisfy the following conditions:

- (1) the borrower's claim against the third party *institution* is openly pledged or assigned to the *lending firm* and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions;
- (2) the third party *institution* is notified of the pledge or assignment;
- (3) as a result of the notification, the third party *institution* is able to make payments solely to the *lending firm* or to other parties with the *lending firm's* consent; and
- (4) the pledge or assignment is unconditional and irrevocable.

[Note: BCD Annex VIII Part 2 point 12]

Deposits with third parties: Calculating the effects of the credit risk mitigation

- 5.5.3 **R** Where the conditions set out in **BIPRU 5.5.2 R** are satisfied, credit protection falling within the terms of **BIPRU 5.5.1 R** may be treated as a guarantee by the third party *institution*.

[Note: BCD Annex VIII Part 3 point 79]

Life insurance policies: Eligibility

- 5.5.4 **R** Life insurance policies pledged to a *lending firm* may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 24]

Life insurance policies: Minimum requirements

5.5.5

R

For life insurance policies pledged to a *lending firm* to be recognised the following conditions must be met:

- (1) the party providing the life insurance must be subject to the *Solvency II Directive*, or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Community;
- (2) the life insurance policy is openly pledged or assigned to the *lending firm*;
- (3) the party providing the life insurance is notified of the pledge or assignment and as a result may not pay amounts payable under the contract without the consent of the *lending firm*;
- (4) the *surrender value* is declared by the company providing the life insurance and is non-reducible;
- (4A) the *surrender value* must be paid in a timely manner upon request;
- (4B) the *surrender value* must not be requested without the consent of the *lending firm*;
- (5) the *lending firm* must have the right to cancel the policy and receive the surrender value in a timely way in the event of the default of the borrower;
- (6) the *lending firm* is informed of any non-payments under the policy by the policyholder;
- (7) the credit protection must be provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the *lending firm* must ensure that the amount deriving from the insurance contract serves the *lending firm* as security until the end of the duration of the credit agreement; and
- (8) the pledge or assignment must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

[Note: BCD Annex VIII Part 2 point 13 (part)]

5.5.6

R

Where it is not possible for a *firm* to meet the condition set out in ■ BIPRU 5.5.5 R (7), because the insurance relationship ends before the loan relationship expires, the *firm* must ensure that the amount deriving from the insurance contract serves the *firm* as security until the end of the duration of the credit agreement.

[Note: BCD Annex VIII Part 2 point 13 (part)]

Life insurance policies: Calculating the effects of the credit risk mitigation

5.5.7

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- (1) Where the conditions set out in ■ BIPRU 5.5.5 R are satisfied, the portion of the *exposure* collateralised by the current *surrender value*

of credit protection falling within the terms of ■ BIPRU 5.5.4 R must be either:

- (a) subject to the *risk weights* specified in (3) where the *exposure* is subject to the *standardised approach* to credit risk; or
 - (b) assigned an *LGD* of 40% where the *exposure* is subject to the *IRB approach* but not subject to the *firm's* own estimates of *LGD*.
- (2) In case of a currency mismatch, the current *surrender value* must be reduced according to ■ BIPRU 5.7.17 R and ■ BIPRU 5.7.18R, the value of the credit protection being the current *surrender value* of the life insurance policy.
- (3) For the purpose of (1)(a), the following *risk weights* must be assigned on the basis of the *risk weight* assigned to a senior unsecured *exposure* to the company providing the life insurance:
- (a) a *risk weight* of 20%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 20%;
 - (b) a *risk weight* of 35%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 50%;
 - (c) a *risk weight* of 70%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 100%; and
 - (d) a *risk weight* of 150%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 150%.

[Note: BCD Annex VIII Part 3 point 80]

Instruments purchased on request: Eligibility

- 5.5.8 **R** Instruments issued by third party *institutions* which will be repurchased by that *institution* on request may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 25]

Instruments purchased on request: Calculating the effects of the credit risk mitigation

- 5.5.9 **R** Instruments eligible under ■ BIPRU 5.5.8 R may be treated as a guarantee by the issuing *institution*.

[Note: BCD Annex VIII Part 3 point 81]

- 5.5.10 **R** For the purposes of ■ BIPRU 5.5.9 R, the value of the credit protection recognised is the following:

- (1) where the instrument will be repurchased at its face value, the value of the protection is that amount; or

(2) where the instrument will be repurchased at market price, the value of the protection is the value of the instrument valued in the same way as the *debt securities* specified in ■ BIPRU 5.4.5 R.

[Note: BCD Annex VIII Part 3 point 82]

Credit linked notes

5.5.11

R

Investments in credit linked notes issued by a *lending firm* may be treated as cash collateral.

[Note: BCD Annex VIII Part 3 point 3]