

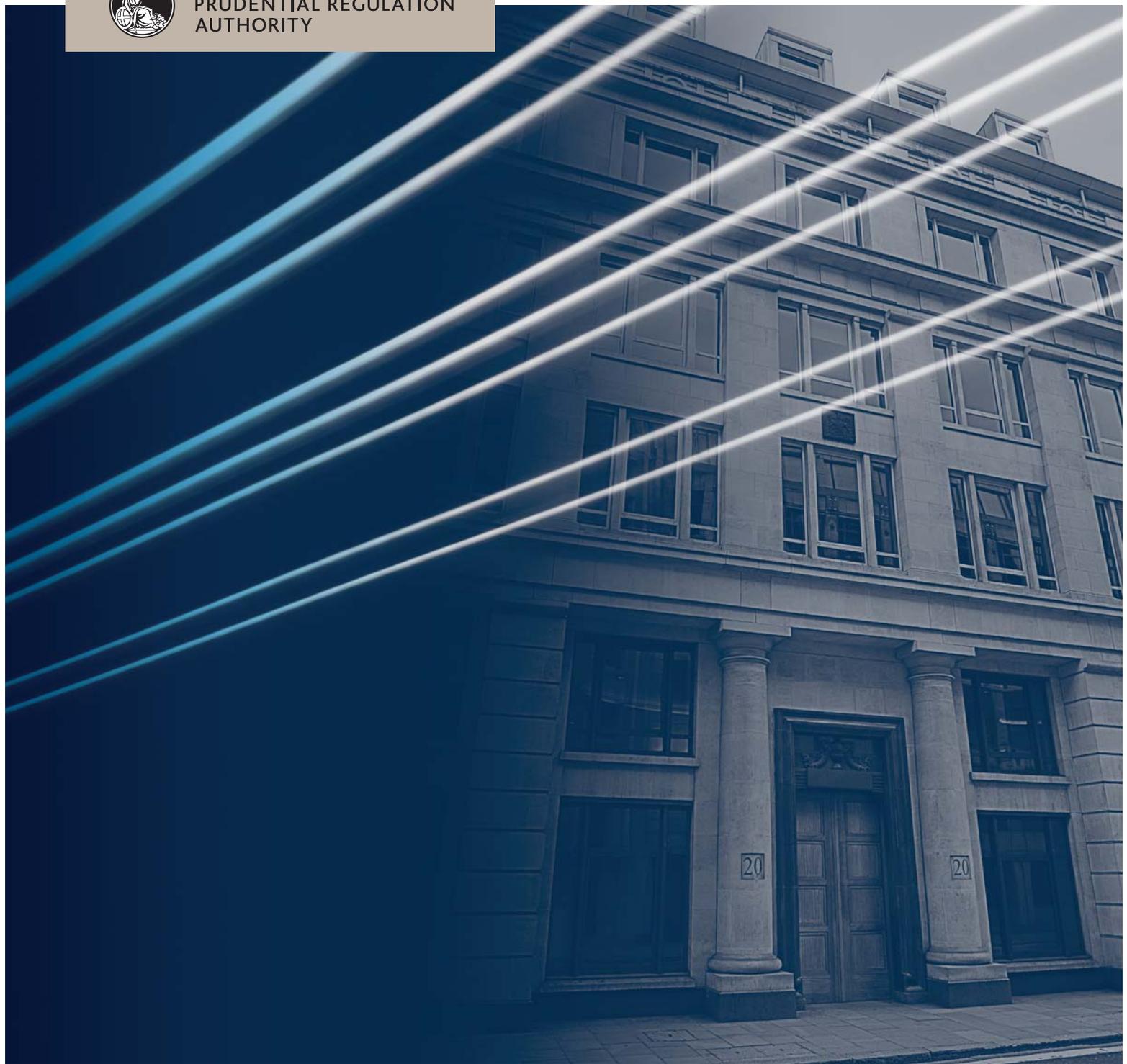
Supervisory Statement | SS10/13

Standardised approach

December 2013



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

Prudential Regulation Authority, registered office: 8 Lothbury, London EC2R 7HH.
Registered in England and Wales No: 07854923



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS10/13

Standardised approach

December 2013

1 Introduction

1.1 This statement is aimed at firms to which CRD IV applies.

1.2 The purpose of this statement is to set out the Prudential Regulation Authority's (PRA's) expectations in respect of certain aspects of a firm's implementation of the standardised approach to credit risk.

2 Exposures to institutions

2.1 The PRA confirms that, in relation to the concessionary treatment set out in CRR Article 119(5), there are no financial institutions currently authorised and supervised by it — other than those to which the CRR applies directly — that are subject to prudential requirements that the PRA considers to be comparable in terms of robustness to those applied to institutions under the CRR.

(CRR Article 119(5))

3 Third country equivalence

3.1 CRR articles 107(3), 114(7), 115(4), 116(5) and 132(3) each include a third country equivalence provision which allows a certain credit risk treatment to be applied where a non-EEA jurisdiction ('third country') applies prudential and supervisory requirements at least equivalent to those applied in the European Union. The Commission is empowered under each of these provisions to make a decision as to which countries apply equivalent arrangements. Prior to the end of 2013, the PRA will set out the approach to be taken during 2014 in the absence of an equivalent determination by the European Commission.

(CRR Articles 107(3), 107(4), 114(7), 115(4), 116(5) and 132(3))

4 Retail exposures

4.1 Where an exposure is denominated in a currency other than the Euro, the PRA expects firms to use appropriate and consistent exchange rates to determine compliance with relevant CRR thresholds. Accordingly, the PRA expects a firm to calculate the Euro equivalent value of the exposure for the purposes of establishing compliance with the aggregate monetary limit of €1 million for retail exposures using a set of exchange rates the firm considers to be appropriate. The PRA expects a firm's choice of exchange rate to have no obvious bias and to be derived on the basis of a consistent approach.

(CRR Article 23(c))

5 Exposures fully and completely secured by mortgages on residential property

Ijara mortgages

5.1 The PRA considers an Ijara mortgage to be an example 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.

5.2 Accordingly, the PRA expects exposures to Ijara mortgages to be subject to all of the requirements applicable to exposures secured by mortgages on residential property including in respect of periodic property revaluation.

(CRR Articles 124 and 125)

Buy-to-let mortgages

5.3 The United Kingdom has a well-developed and long-established residential property market. For example, in 1987, the amount outstanding of total Sterling net secured lending to individuals and housing associations (not seasonally adjusted) was £166 billion; in 2012, such lending stood at £1.3 trillion.⁽¹⁾

5.4 The write-off rate for UK residential mortgages in 2012, calculated using Bank of England data, was 0.05%.⁽²⁾ Pending the availability of annual loss rates collected on a uniform basis through COREP, the PRA considers this write-off rate to be a suitable proxy for the loss rates referred to in CRR Articles 125(3) and 199(3).⁽³⁾

5.5 The write-off rates for the seventeen years prior to 2012 are set out below:

• 2011	0.06%;
• 2010	0.08%;
• 2009	0.13%;
• 2008	0.07%;
• 2007	0.03%;
• 2006	0.03%;
• 2005	0.01%;
• 2004	0.00%;
• 2003	0.02%;
• 2002	0.01%;
• 2001	0.03%;
• 2000	0.04%;
• 1999	0.07%;
• 1998	0.08%;

(1) These data may be found in Bank of England data series LPQVTXH.

(2) The write-off rate was calculated using seasonally unadjusted data extracts from Bank of England series RPATBVX and RPATFHD.

(3) The data have been gathered on the basis of the Bank's reporting form WO which collects data in respect of both complete and partial write-offs as well as write-ons.

- 1997 0.15%;
- 1996 0.11%; and
- 1995 0.12%.

(CRR Articles 125(3) and 199(3))

6 Exposures in default

6.1 When determining the portion of a past due item that is secured, the PRA expects the secured portion of an exposure covered by a mortgage indemnity product that is eligible for credit risk mitigation purposes under Chapter 4 of the CRR potentially to be capable of qualifying as an eligible guarantee.

(CRR Article 129(2))

7 Items associated with particularly high risk

7.1 When determining whether exposures in the form of units or shares in a collective investment undertaking (CIU) are associated with particularly high risk, the PRA expects the following features would be likely to give rise to such risk:

- (a) an absence of external credit assessment of the CIU from an external credit assessment institution (ECAI) recognised under the provisions of Article 132(2) of the CRR, 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 set out in Article 132(3) of the CRR; and
- (b) a substantial element of the CIU's property is made up of items that would be subject to a risk weight of more than 100%, or the mandate of a CIU would permit it to invest in a substantial amount of such items.

7.2 The PRA would expect a firm's assessment of whether types of exposure referred to in Article 128(3) of the CRR are associated with particularly high risk to include consideration of exposures arising out of a venture capital business — whether the firm itself carries on the venture capital business or not — to be associated with particularly high risk. The PRA considers 'venture capital business' to include the business of carrying on any of the following:

- (a) managing investments which are, arranging (bringing about) transactions in, or making arrangements with a view to transactions in, venture capital investments;
- (b) managing investments in relation to portfolios, or establishing, operating or winding up collective investment schemes, where the portfolios or collective investment schemes (apart from funds awaiting investment) invest only in venture capital investments;

(c) any custody activities provided in connection with the activities in (a) or (b); and

(d) any related ancillary activities.

(CRR Article 128)

8 Mapping of ECAI credit assessments

8.1 Until such time as the European Commission adopts implementing technical standards drafted by the Joint Committee of the European Supervisory Agencies specifying for all ECAIs the relevant credit assessments of the ECAI that correspond to the credit quality steps set out in the CRR, the PRA expects firms to continue to use **Table 1** for the purposes of mapping the credit assessments of the specified ECAIs to credit quality steps.

Table 1 Mapping of ECAIs' credit assessments to credit quality steps for the purposes of the standardised approach**Long-term mapping**

Credit quality step	Fitch's s assessment	Moody's assessments	S&P's assessments	DBRS assessments	Corporate	Institution (includes banks)		Sovereign	
						Sovereign method	Credit assessment method		
							Maturity > three months		Maturity three months or less
1	AAA to AA-	Aaa to Aa3	AAA to AA-	AAA to AAL	20%	20%	20%	20%	0%
2	A+ to A-	A1 to A3	A+ to A-	AH to AL	50%	50%	50%	20%	20%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBBH to BBBL	100%	100%	50%	20%	50%
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BBH to BBL	100%	100%	100%	50%	100%
5	B+ to B-	B1 to B3	B+ to B-	BH to BL	150%	100%	100%	50%	100%
6	CCC+ and below	Caa1 and below	CCC+ and below	CCCH and below	150%	150%	150%	150%	150%

Short-term mapping

Credit quality step	Fitch	Moody's	S&P	DBRS	Risk weights
1	F1+, F1	P-1	A-1+, A-1	R-1 (high), R-1 (middle), R-1 (low)	20%
2	F2	P-2	A-2	R-2 (high), R-2 (middle), R-2 (low)	50%
3	F3	P-3	A-3	R-3	100%
4	Below F3	NP	B-1, B-2, B-3, C	R-4, R-5	150%
5					150%
6					150%

Collective investment undertakings (CIUs)

Credit quality step	Risk weights	Fitch	Moody's	S&P	S&P
1	20%	AAA to AA-	Aaa to Aa3	Principal stability funds ratings AAA-m to AA-m	Fund credit quality ratings AAA-f to AA-f
2	50%	A+ to A-	A1 to A3	A+m to A-m	A+f to A-f
3	100%	BBB+ to BBB-	Baa1 to Baa3	BBB+m to BBB-m	BBB+f to BBB-f
4	100%	BB+ to BB-	Ba1 to Ba3	BB+m to BB-m	BB+f to BB-f
5	150%	B+ to B-	B1 to B3	B+m to B-m	B+f to B-f
6	150%	CCC+ and below	Caa1 and below	CCC+ m and below	CCC+f and below