

Supervisory Statement | SS10/13

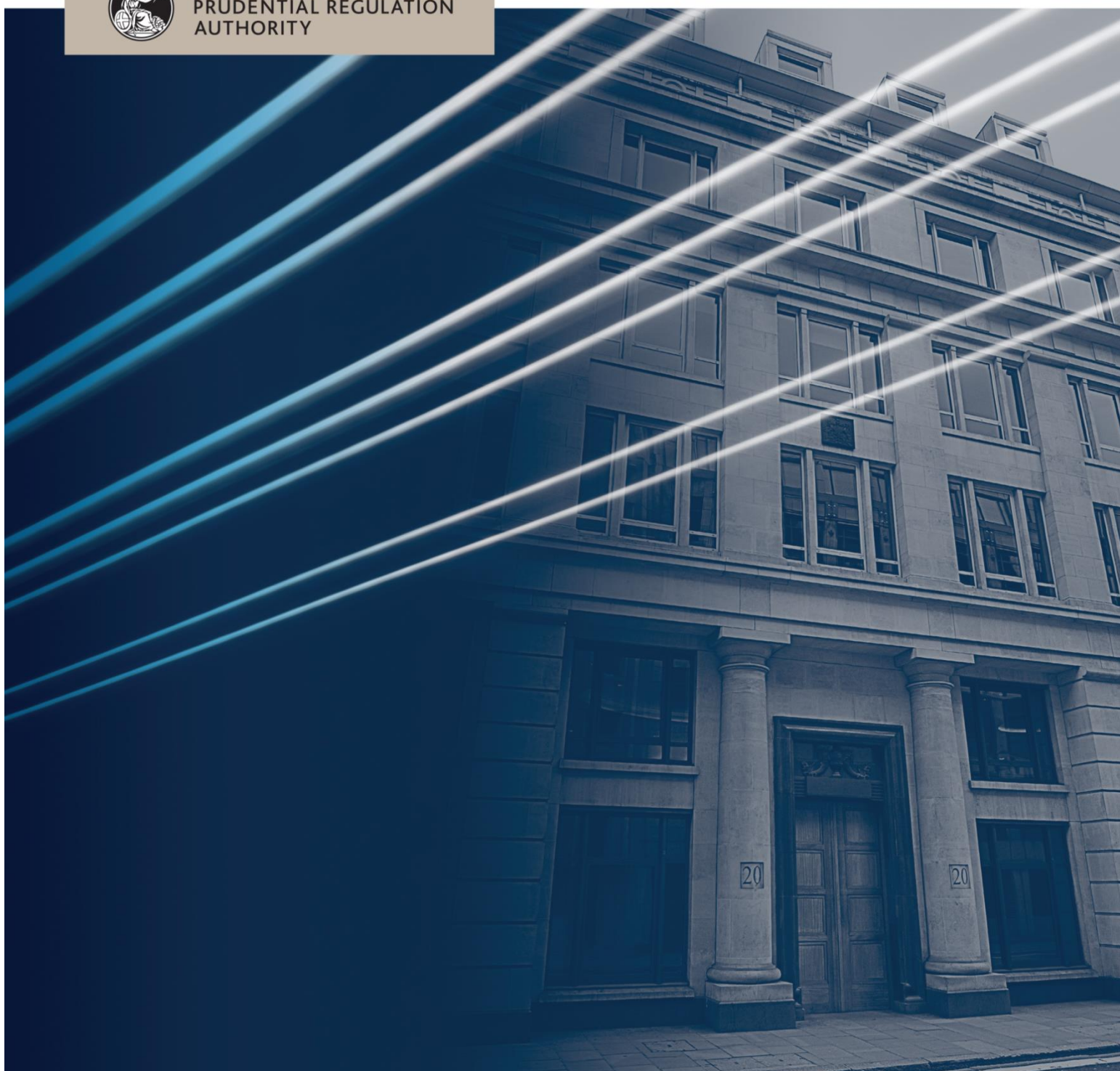
Standardised approach

July 2026

(Updating May 2020)



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY





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1 Introduction

1.1 The purpose of this Supervisory Statement (SS) is to provide clarification to firms of the Prudential Regulation Authority's (PRA) expectations in respect of the standardised approach to credit risk (SA).

1.2 This SS applies to PRA-authorised banks, building societies, PRA-designated investment firms, and PRA-approved or PRA-designated financial or mixed financial holding companies (collectively 'firms').

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3A Exposures to unrated corporates

3A.1 Article 122(6) of the Credit Risk: Standardised Approach (CRR) Part of the PRA Rulebook allows a firm using the SA, subject to PRA permission, to assign risk weights that are different to the treatment set out in Article 122(5) of the Credit Risk: Standardised Approach (CRR) Part, to exposures to corporates for which a credit assessment is not available from a nominated eligible credit assessment institution (ECAI) ('unrated corporates'). The PRA will only grant a permission to use the risk weight treatment set out in Article 122(6) of the Credit Risk: Standardised Approach (CRR) Part where a firm demonstrates, to the satisfaction of the PRA, that the criteria specified in Article 122(6) of the Credit Risk: Standardised Approach (CRR) Part are met. The PRA's expectations in respect of these criteria are outlined below.

3A.2 A firm applying for a permission for use of the risk weight treatment under Article 122(6) of the Credit Risk: Standardised Approach (CRR) Part must demonstrate, to the satisfaction of the PRA, that it has sound, effective and comprehensive strategies, processes, systems, and risk management practices. These must enable the firm to identify and manage its sources of credit and counterparty risk adequately, and therefore enable it to robustly distinguish between investment grade and non-investment grade unrated corporate exposures.

3A.3 For the purpose of determining if these requirements are met, the PRA will consider whether:

- the firm has robust risk management processes, procedures, and controls at subsidiary level and consolidated level, where relevant, to ensure that the use of the permission would not result in inadequate capitalisation of risk due to imprudent allocation of exposures between investment grade and non-investment grade;
- credit and counterparty credit risk arising from exposures to corporates where an external rating is not available from a nominated ECAI has been, and will be, clearly identified in the firm's internal capital adequacy assessment process (ICAAP), and will be actively managed;

- the allocation of exposures between investment grade and non-investment grade for regulatory purposes is consistent with the firm's own internal risk management systems and is consistent with the firm's due diligence practices; and
- there is an attestation, either from the firm's Internal Audit function, or a competent external party, that the firm has sufficient and adequate processes to robustly distinguish between investment and non-investment grade unrated corporate exposures, and to robustly monitor the allocation on an ongoing basis.

3A.4 The PRA will make a broader assessment of whether it is appropriate to grant a permission, even where the criteria in Article 122(6) of the Credit Risk: Standardised Approach (CRR) Part are met. In particular, the PRA will consider whether the proposed treatment is appropriate in the context of the overall business model of the firm, and whether granting the permission would advance the PRA's safety and soundness objective.

Assessment of investment grade unrated corporates

3A.5 The PRA expects that, for the purpose of Article 122(9) of the Credit Risk: Standardised Approach (CRR) Part, an 'investment grade' counterparty should broadly reflect a similar level of credit risk as an exposure to a rated counterparty that has a credit assessment by an ECAI that maps to a Credit Quality Step of 1, 2 or 3 for the purpose of determining risk weights according to the Credit Risk: Standardised Approach (CRR) Part.

4 Retail exposures

4.1 Where an exposure is denominated in a currency other than sterling, the PRA expects firms to use appropriate and consistent exchange rates to determine compliance with the monetary thresholds set out in the Credit Risk: Standardised Approach (CRR) Part. Accordingly, the PRA expects a firm to use a set of exchange rates that the firm considers to be appropriate to calculate the sterling equivalent value of the total amount owed by an obligor or group of connected clients for the purposes of establishing compliance with the monetary limits of £880,000 that are used to define retail exposures and regulatory retail exposures, as set out in Articles 123 and 123A of the Credit Risk: Standardised Approach (CRR) Part. 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 over time and across portfolios.

Transactors

4.2 The PRA considers that, where a technical event has occurred, an obligor should not be considered to have failed to repay the balance of a revolving facility, or have drawn down an overdraft facility, for the purpose of the definition of transactor exposure set out in the Glossary Part of the PRA Rulebook.

4.3 For the purpose of paragraph 4.2, a technical event should only be considered to have occurred in the following cases:

- (a) where a firm identifies that the delayed or incomplete repayment, or drawdown of an overdraft facility, was a result of a data or system error of the firm, including manual errors of standardised processes;

- (b) where a firm identifies that the delayed or incomplete repayment, or drawdown of an overdraft facility, was a result of the non-execution, defective or late execution of the payment transaction ordered by the obligor, or where there is evidence that the payment was unsuccessful due to the failure of the payment system; and
- (c) where, due to the nature of the transaction, there is a time lag between the receipt of the payment by a firm and the allocation of that payment to the relevant account, so that the payment was made on or before the scheduled repayment date (or, for an overdraft facility, on or before the facility was drawn down), but the crediting of the client's account took place after the scheduled repayment date (or, for an overdraft facility, after the facility was drawn down).

5 Real estate exposures

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 real estate exposures 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 residential real estate exposures, including in respect of property revaluation.¹

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Retirement interest-only (RIO) mortgages

Material previously in this section is now covered in Chapters 3 and 5 of SS3/24 - Definition of default.²

Definition of residential real estate

5.9 The PRA expects firms to have a clear documented policy for determining the predominant nature of a property for the purpose of applying the definition of residential real estate set out in the Glossary Part.

5.10 The PRA considers it unlikely that care homes, purpose-built student accommodation and holiday lets would meet the definition of residential real estate set out in the Glossary Part unless the collateral is capable of being resold as a standard residential dwelling in the event of the borrower's default. The PRA expects that property subject to any usage restrictions that would prevent it from being occupied as a residential dwelling on a permanent and continuous basis would not meet the definition of residential real estate.

Mixed real estate exposures

5.11 As set out in Rule 1.2 of the Credit Risk: Standardised Approach (CRR) Part, mixed real estate exposures are non-acquisition, development, and construction (non-ADC) real estate exposures that are secured by both residential and commercial real estate (ie they are not secured by a single property). For

¹ Article 124D of the Credit Risk: Standardised Approach (CRR) Part

² <https://www.bankofengland.co.uk/prudential-regulation/publication/2024/september/credit-risk-definition-of-default-supervisory-statement>

the purpose of determining whether each individual property is residential or commercial real estate, firms should assess the predominant nature of the property in accordance with paragraph 5.9.

5.12 For a mixed real estate exposure, firms are required to split the exposure into a residential real estate exposure and a commercial real estate exposure, in accordance with Article 124(4) of the Credit Risk: Standardised Approach (CRR) Part. This should be done in a consistent manner for all elements of the exposure (including off-balance sheet and on-balance sheet elements). To determine the risk weight applied to each part of the exposure, firms should separately consider whether the residential real estate exposure part and the commercial real estate exposure part are deemed to be materially dependent on the cash flows generated by the property.

Examples of the 'loan splitting approach'

5.13 The PRA has set out examples for the calculation of risk weighted assets under the 'loan splitting approach' in accordance with Article 124F and Articles 124H(1) and 124H(2) of the Credit Risk: Standardised Approach (CRR) Part below:

- (a) Example 1: A loan of £80,000 to a natural person secured on the borrower's primary residence, where the value of the property is £100,000.

To calculate risk weighted assets, the firm would apply a risk weight of 20% to the exposure amount up to 55% of the property value (£55,000) and a risk weight of 75% to the residual exposure of £25,000. This gives total risk weighted assets for the exposure of £29,750 = $(20\% * £55,000) + (75\% * £25,000)$. The resultant risk weight would be 37.19%.

- (b) Example 2: A fully undrawn loan of £80,000 to a natural person secured on the borrower's primary residence (which is located in the UK), where the value of the property is £100,000.

To calculate risk weighted assets, the firm would first calculate the exposure amount up to 55% of the property value that must be assigned a 20% risk weight. The loan is fully undrawn (ie off balance sheet) and secured on a UK property meaning a 50% conversion factor applies. The exposure amount to which the risk weight of 20% is applied is therefore £40,000 ($50\% * £80,000$). This gives total risk weighted assets for the exposure of £8,000 ($20\% * £40,000$). The resultant risk weight would be 20%.

- (c) Example 3: Where a firm holds a charge and there are charges not held by the firm that rank in priority ahead of the charge that the exposure is secured by ('senior charges'). For example, a loan of £70,000 to a natural person secured on the borrower's primary residence, where the value of the property is £100,000, and there is a senior charge of £10,000 held by another firm.

To determine the part of the firm's exposure that is eligible for the 20% risk weight, the amount up to 55% of the property value must be reduced by the amount of the senior charges not held by the firm.

In this example, to calculate the risk weighted assets, the firm would reduce the amount of the exposure to which the risk weight of 20% is assigned by £10,000, resulting in the application of a risk weight of 20% being applied to £45,000 of the exposure (instead of £55,000 in the absence of

the senior charge) and a risk weight of 75% being applied to the residual exposure of £25,000. This gives total risk weighted assets for the exposure of £27,750 ($20\% * £45,000 + (75\% * £25,000)$). The resultant risk weight would be 39.64%.

- (d) Example 4: Where a firm holds a charge and there are charges held by another firm that rank pari passu with the firm's charge. For example, a loan of £70,000 to a natural person secured on the borrower's primary residence, where the value of the property is £100,000, and there is a charge that ranks pari passu of £10,000 held by another firm.

There are several steps to determine the part of the firm's exposure that is eligible for the 20% risk weight. First, the amount up to 55% of the property value must be reduced by the amount of any charges not held by the firm that rank in priority ahead of the charge that the exposure is secured by. In this example there are no such charges so no such reduction is made. Second, this amount must be reduced by the product of:

- (i) the remaining amount up to 55% of the property value after the reduction of any charges not held by the firm that rank in priority ahead of the charge that the exposure is secured by; and
- (ii) the amount of charges not held by the firm that rank pari passu with the firm's charge that the exposure is secured by, divided by the sum of all pari passu charges.

The firm would therefore calculate the exposure amount to which the 20% risk weight is assigned as £48,125 ($(£55,000 - £0) - (£55,000 - £0) * (£10,000 / (£10,000 + £70,000))$). A 75% risk weight is applied to the residual exposure of £21,875. This gives total risk weighted assets for the exposure of £26,031 ($(20\% * £48,125) + (75\% * £21,875)$). The resultant risk weight would be 37.19%.

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9 Currency mismatch multiplier

9.1 The PRA expects firms to have in place effective internal policies, processes, systems and controls to consider whether the currency mismatch multiplier should be applied to retail and residential real estate exposures in accordance with Article 123B of the Credit Risk: Standardised Approach (CRR) Part (including as part of their due diligence processes where applicable).

9.2 In accordance with Article 123B of the Credit Risk: Standardised Approach (CRR) Part, firms must apply the currency mismatch multiplier to an exposure where both of the following criteria are met:

- (a) the first criterion is that a currency mismatch exists, ie the lending currency differs from the currency of the relevant source of income (as set out in Article 123B(1)(a) or Article 123B(1)(b)(ii) of the Credit Risk: Standardised Approach (CRR) Part); and
- (b) the second criterion is that the exposure is not sufficiently hedged (as set out in Article 123B(2)(a) of the Credit Risk: Standardised Approach (CRR) Part) in the lending currency.

The PRA considers that where one of the criteria is not met for a particular exposure, it is not necessary for a firm to assess that exposure against the other criterion.

9.3 For the purpose of the first criterion, to determine whether there is a currency mismatch, the PRA considers that it is generally sufficient for firms to assess whether the obligor's (or where relevant the guarantor's) main source of income differs in currency from that of the loan. An example of a case where this would not be sufficient is where the currency of the obligor's main source of income matches the lending currency, but only covers a small share of the loan instalment. In such cases, firms should consider an obligor's other sources of income in determining whether there is a currency mismatch.

9.4 For the purpose of the second criterion, to determine whether the exposure is sufficiently hedged against the lending currency, a firm need not consider all sources of income that may constitute a natural hedge, provided that the assessed natural hedges, together with any financial hedges, cover at least 90% of any instalment for the exposure.

9.5 The PRA does not consider that it is necessary for firms to request new information from obligors on an ongoing basis to monitor whether a currency mismatch multiplier needs to be applied; however, the PRA expects firms to reassess whether an exposure is subject to the currency mismatch multiplier in any of the following circumstances:

- (a) in a case where the currency mismatch multiplier is not applied on the basis that the first criterion is not met: the obligor has provided new information that suggests the currency of their source of income has changed; or
- (b) in a case where the currency mismatch multiplier is not applied on the basis that the second criterion is not met:
 - i. the firm has received information that the value of any natural hedges has changed. This includes changes to the value of any assets being counted as a natural hedge; or
 - ii. subject to paragraph 9.6, the value of any instalment for the exposure has changed.

9.6 As an exception to paragraph 9.5(b)(ii), the PRA considers that it is sufficient for a firm to reassess whether a currency mismatch multiplier needs to be applied when the value of any instalment for the exposure has changed materially since the last assessment in cases where:

- (a) the instalment value can change on a daily basis, and a daily reassessment would be unduly burdensome; and

- (b) the firm has a suitable process in place for identifying whether the value of any instalment for the exposure has changed materially since the last assessment (such a process could for example be based on a combination of regular checks and specified triggers).

10 Commitments

10.1 To determine the exposure value for off-balance sheet items in accordance with Article 111 of the Credit Risk: Standardised Approach (CRR) Part, firms are required to multiply the applicable conversion factor by the nominal value of the off-balance sheet item (after certain adjustments). The PRA considers that, in the case of commitments, firms need not include any unadvised limit in this nominal value.

11 External Credit Ratings

11.1 For the purpose of risk weighting exposures to institutions, firms must not use an ECAI credit assessment that incorporates assumptions of implicit government support in accordance with Article 138(1)(g) of the Credit Risk: Standardised Approach (CRR) Part.

11.2 Where an ECAI's credit assessment methodology includes considerations of implicit government support, but the ECAI attributes no value for implicit government support in the final credit assessment and has stated this publicly, the PRA considers that the credit assessment should not be treated as incorporating assumptions of implicit government support. Where a firm is using a credit assessment that attributes no value to implicit government support, it should have in place robust processes to ensure that it ceases to use the credit assessment if it is updated in a manner that starts assigning value to any implicit government support.

11.3 Firms must nominate ECAIs for risk weighting in a way that is consistent with their use of ECAIs in their risk management processes in accordance with Article 138(1) of the Credit Risk: Standardised Approach (CRR) Part. The PRA considers that this does not require a firm to nominate every ECAI that is used for risk management purposes. The PRA considers that a firm's nomination of ECAIs would in principle be consistent with its use of ECAIs in its risk management processes in either of the following circumstances:

- (a) the firm uses multiple ECAIs in its risk management processes for a group of exposures but has only nominated one or more of these ECAIs for risk weighting purposes; or
- (b) the firm uses a single ECAI in its risk management processes for a group of exposures which does not represent a material portion of a firm's total exposures across all exposure classes, and the firm has not nominated the ECAI for risk weighting purposes.

11.4 Where a firm uses different ECAIs in its risk management processes for different groups of exposures, which each represent a material portion of a firm's total exposures, the PRA considers that the firm's nomination of ECAIs will only be consistent with its use of ECAIs in its risk management processes in accordance with Article 138(1) of the Credit Risk: Standardised Approach (CRR) Part if it has nominated sufficient ECAIs such that at least one nominated ECAI is used for risk management purposes for each material group of exposures.

11.5 In accordance with Article 138(1) of the Credit Risk: Standardised Approach (CRR) Part, firms should consider credit assessments from a nominated ECAI when assigning risk weights to all exposures for

which a credit assessment is available from the nominated ECAI, irrespective of the type of exposure, or whether the ECAI is used for the risk management of that particular exposure.

11.6 In accordance with Article 139(2) of the Credit Risk: Standardised Approach (CRR) Part, for an exposure for which no issue-specific credit assessment is available from a nominated ECAI, a firm must apply a credit assessment from a nominated ECAI associated with a different issue or the general credit assessment of the issuer if certain conditions are met. Where these conditions are met in respect of:

- (a) the general credit assessment of the issuer and credit assessments of one or more issues, or
- (b) credit assessments of multiple issues,

the PRA considers that a firm should use a credit assessment of the issue which is closest in economic substance to the exposure in question (or a general credit assessment of the issuer, if the exposure in question is closest in economic substance to a senior unsecured exposure).

11.7 In making the assessment referred to in paragraph 11.6, firms should consider where the exposure sits in the debt hierarchy relative to the rated issuances and/or senior unsecured exposures, as applicable. The PRA considers that, in general, the rated issue that is closest in economic substance to the exposure in question is likely to be the issue which ranks closest to it in priority in the creditor hierarchy. Once a firm has determined if a general credit assessment of the issuer or a credit assessment of a particular issue should be used, if such a credit assessment is available from multiple nominated ECAIs, the applicable credit assessment must be determined in accordance with Article 138(1) of the Credit Risk: Standardised Approach (CRR) Part.

12 Equity exposures

12.1 For the purpose of risk weighting equity exposures in accordance with Article 133 of the Credit Risk: Standardised Approach (CRR) Part, firms are required to measure the age of an undertaking from the date of its establishment, when determining whether an exposure is a higher risk equity exposure in accordance with the definition in the Glossary Part.

12.2 The PRA expects firms to take the date of incorporation for a body corporate or partnership, or the date of the business commencing for an unincorporated association, as the date of establishment of an undertaking, except in the following circumstances:

- (a) where firms observe that the undertaking has been dormant, through trading inactivity or otherwise, firms should take the date that trading activity first commenced or recommenced as appropriate as the date of establishment; and
- (b) where an undertaking is not trading, but is otherwise active, such as through the research and development of products, hiring of employees, or other forms of revenue generation, firms should take the date of the first of these events commencing as the date of establishment.