Directive 2006/48/EC of the European Parliament and of the council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (Text with EEA relevance) (repealed)

TITLE V

PRINCIPLES AND TECHNICAL INSTRUMENTS FOR PRUDENTIAL SUPERVISION AND DISCLOSURE

CHAPTER 2

Technical instruments of prudential supervision

Section 3

Minimum own funds requirements for credit risk

Subsection 2

Internal Ratings Based Approach

Article 84

1 In accordance with this Subsection, the competent authorities may permit credit institutions to calculate their risk-weighted exposure amounts using the Internal Ratings Based Approach ('IRB Approach'). Explicit permission shall be required in the case of each credit institution.

2 Permission shall be given only if the competent authority is satisfied that the credit institution's systems for the management and rating of credit risk exposures are sound and implemented with integrity and, in particular, that they meet the following standards in accordance with Annex VII, Part 4:

a the credit institution's rating systems provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;

b internal ratings and default and loss estimates used in the calculation of capital requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the credit institution;

c the credit institution has a credit risk control unit responsible for its rating systems that is appropriately independent and free from undue influence;

d the credit institution collects and stores all relevant data to provide effective support to its credit risk measurement and management process; and

e the credit institution documents its rating systems and the rationale for their design and validates its rating systems.

Where an EU parent credit institution and its subsidiaries or an EU parent financial holding company and its subsidiaries use the IRB Approach on a unified basis, the

competent authorities may allow minimum requirements of Annex VII, Part 4 to be met by the parent and its subsidiaries considered together.

3 A credit institution applying for the use of the IRB Approach shall demonstrate that it has been using for the IRB exposure classes in question rating systems that were broadly in line with the minimum requirements set out in Annex VII, Part 4 for internal risk measurement and management purposes for at least three years prior to its qualification to use the IRB Approach.

4 A credit institution applying for the use of own estimates of LGDs and/or conversion factors shall demonstrate that it has been estimating and employing own estimates of LGDs and/or conversion factors in a manner that was broadly consistent with the minimum requirements for use of own estimates of those parameters set out in Annex VII, Part 4 for at least three years prior to qualification to use own estimates of LGDs and/or conversion factors.

5 If a credit institution ceases to comply with the requirements set out in this Subsection, it shall either present to the competent authority a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

6 When the IRB Approach is intended to be used by the EU parent credit institution and its subsidiaries, or by the EU parent financial holding company and its subsidiaries, the competent authorities of the different legal entities shall cooperate closely as provided for in Articles 129 to 132.

Article 85

1 Without prejudice to Article 89, credit institutions and any parent undertaking and its subsidiaries shall implement the IRB Approach for all exposures.

Subject to the approval of the competent authorities, implementation may be carried out sequentially across the different exposure classes, referred to in Article 86, within the same business unit, across different business units in the same group or for the use of own estimates of LGDs or conversion factors for the calculation of risk weights for exposures to corporates, institutions, and central governments and central banks.

In the case of the retail exposure class referred to in Article 86, implementation may be carried out sequentially across the categories of exposures to which the different correlations in Annex VII, Part 1, points 10 to 13 correspond.

2 Implementation as referred to in paragraph 1 shall be carried out within a reasonable period of time to be agreed with the competent authorities. The implementation shall be carried out subject to strict conditions determined by the competent authorities. Those conditions shall be designed to ensure that the flexibility under paragraph 1 is not used selectively with the purpose of achieving reduced minimum capital requirements in respect of those exposure classes or business units that are yet to be included in the IRB Approach or in the use of own estimates of LGDs and/or conversion factors.

3 Credit institutions using the IRB Approach for any exposure class shall at the same time use the IRB Approach for the equity exposure class.

4 Subject to paragraphs 1 to 3 of this Article and Article 89, credit institutions which have obtained permission under Article 84 to use the IRB Approach shall not revert to the use of Subsection 1 for the calculation of risk-weighted exposure amounts except for demonstrated good cause and subject to the approval of the competent authorities.

5 Subject to paragraphs 1 and 2 of this Article and Article 89, credit institutions which have obtained permission under Article 87(9) to use own estimates of LGDs and conversion factors, shall not revert to the use of LGD values and conversion factors referred to in Article

87(8) except for demonstrated good cause and subject to the approval of the competent authorities.

Article 86

1 Each exposure shall be assigned to one of the following exposure classes:

a claims or contingent claims on central governments and central banks;

b claims or contingent claims on institutions;

c claims or contingent claims on corporates;

d retail claims or contingent retail claims;

e equity claims;

f securitisation positions; or

g other non credit-obligation assets.

2 The following exposures shall be treated as exposures to central governments and central banks:

a exposures to regional governments, local authorities or public sector entities which are treated as exposures to central governments under Subsection 1; and

b exposures to Multilateral Development Banks and International Organisations which attract a risk weight of 0 % under Subsection 1.

3 The following exposures shall be treated as exposures to institutions:

a exposures to regional governments and local authorities which are not treated as exposures to central governments under Subsection 1;

b exposures to Public Sector Entities which are treated as exposures to institutions under the Subsection 1; and

c exposures to Multilateral Development Banks which do not attract a 0 % risk weight under Subsection 1.

4 To be eligible for the retail exposure class referred to in point (d) of paragraph 1, exposures shall meet the following criteria:

a they shall be either to an individual person or persons, or to a small or medium sized entity, provided in the latter case that the total amount owed to the credit institution and parent undertakings and its subsidiaries, 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, shall not, to the knowledge of the credit institution, which shall have taken reasonable steps to confirm the situation, exceed EUR 1 million;

b they are treated by the credit institution in its risk management consistently over time and in a similar manner;

c they are not managed just as individually as exposures in the corporate exposure class; and

d they each represent one of a significant number of similarly managed exposures.

The present value of retail minimum lease payments is eligible for the retail exposure class.

5 The following exposures shall be classed as equity exposures:

a non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer; and

b debt exposures the economic substance of which is similar to the exposures specified in point (a).

6 Within the corporate exposure class, credit institutions shall separately identify as specialised lending exposures, exposures which possess the following characteristics:

a the exposure is to an entity which was created specifically to finance and/or operate physical assets;

b the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and

c 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.

7 Any credit obligation not assigned to the exposure classes referred to in points (a), (b) and (d) to (f) of paragraph 1 shall be assigned to the exposure class referred to in point (c) of that paragraph.

8 The exposure class referred to in point (g) of paragraph 1 shall include the residual value of leased properties if not included in the lease exposure as defined in Annex VII, Part 3, paragraph 4.

9 The methodology used by the credit institution for assigning exposures to different exposure classes shall be appropriate and consistent over time.

Article 87

1 The risk-weighted exposure amounts for credit risk for exposures belonging to one of the exposure classes referred to in points (a) to (e) or (g) of Article 86(1) shall, unless deducted from own funds, be calculated in accordance with Annex VII, Part 1, points 1 to 27.

2 The risk-weighted exposure amounts for dilution risk for purchased receivables shall be calculated according to Annex VII, Part 1, point 28. Where a credit institution has full recourse in respect of purchased receivables for default risk and for dilution risk, to the seller of the purchased receivables, the provisions of Articles 87 and 88 in relation to purchased receivables need not be applied. The exposure may instead be treated as a collateralised exposure.

3 The calculation of risk-weighted exposure amounts for credit risk and dilution risk shall be based on the relevant parameters associated with the exposure in question. These shall include probability of default (PD), LGD, maturity (M) and exposure value of the exposure. PD and LGD may be considered separately or jointly, in accordance with Annex VII, Part 2.

4 Notwithstanding paragraph 3, the calculation of risk-weighted exposure amounts for credit risk for all exposures belonging to the exposure class referred to in point (e) of Article 86(1) shall be calculated in accordance with Annex VII, Part 1, points 17 to 26 subject to approval of the competent authorities. Competent authorities shall only allow a credit institution to use the approach set out in Annex VII, Part 1, points 25 and 26 if the credit institution meets the minimum requirements set out in Annex VII, Part 4, points 115 to 123.

5 Notwithstanding paragraph 3, the calculation of risk weighted exposure amounts for credit risk for specialised lending exposures may be calculated in accordance with Annex VII, Part 1, point 6. Competent authorities shall publish guidance on how credit institutions should assign risk weights to specialised lending exposures under Annex VII, Part 1, point 6 and shall approve credit institution assignment methodologies.

6 For exposures belonging to the exposure classes referred to in points (a) to (d) of Article 86(1), credit institutions shall provide their own estimates of PDs in accordance with Article 84 and Annex VII, Part 4.

7 For exposures belonging to the exposure class referred to in point (d) of Article 86(1), credit institutions shall provide own estimates of LGDs and conversion factors in accordance with Article 84 and Annex VII, Part 4.

8 For exposures belonging to the exposure classes referred to in points (a) to (c) of Article 86(1), credit institutions shall apply the LGD values set out in Annex VII, Part 2, point 8, and the conversion factors set out in Annex VII, Part 3, point 9(a) to (d).

9 Notwithstanding paragraph 8, for all exposures belonging to the exposure classes referred to in points (a) to (c) of Article 86(1), competent authorities may permit credit institutions to use own estimates of LGDs and conversion factors in accordance with Article 84 and Annex VII, Part 4.

10 The risk-weighted exposure amounts for securitised exposures and for exposures belonging to the exposure class referred to in point (f) of Article 86(1) shall be calculated in accordance with Subsection 4.

11 Where exposures in the form of a collective investment undertaking (CIU) meet the criteria set out in Annex VI, Part 1, points 77 and 78 and the credit institution is aware of all of the underlying exposures of the CIU, the credit institution shall look through to those underlying exposures in order to calculate risk-weighted exposure amounts and expected loss amounts in accordance with the methods set out in this Subsection.

Where the credit institution does not meet the conditions for using the methods set out in this Subsection, risk weighted exposure amounts and expected loss amounts shall be calculated in accordance with the following approaches:

a for exposures belonging to the exposure class referred to in point (e) of Article 86(1), the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures;

b for all other underlying exposures, the approach set out in Subsection 1, subject to the following modifications:

(i) the exposures are assigned to the appropriate exposure class and attributed the risk weight of the credit quality step immediately above the credit quality step that would normally be assigned to the exposure, and

(ii) exposures assigned to the higher credit quality steps, to which a risk weight of 150 % would normally be attributed, are assigned a risk weight of 200 %.

12 Where exposures in the form of a CIU do not meet the criteria set out in Annex VI, Part 1, points 77 and 78, or the credit institution is not aware of all of the underlying exposures of the CIU, the credit institution shall look through to the underlying exposures and calculate risk-weighted exposure amounts and expected loss amounts in accordance with the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures. For these purposes, non equity exposures are assigned to one of the classes (private equity, exchange traded equity or other equity) set out in Annex VII, Part 1, point 19 and unknown exposures are assigned to other equity class.

Alternatively to the method described above, credit institutions may calculate themselves or may rely on a third party to calculate and report the average risk weighted exposure amounts based on the CIU's underlying exposures in accordance with the following approaches, provided that the correctness of the calculation and the report is adequately ensured:

a for exposures belonging to the exposure class referred to in point (e) of Article 86(1), the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange#traded and other equity exposures, it shall treat the exposures concerned as other equity exposures; or

b for all other underlying exposures, the approach set out in Subsection 1, subject to the following modifications:

(i) the exposures are assigned to the appropriate exposure class and attributed the risk weight of the credit quality step immediately above the credit quality step that would normally be assigned to the exposure, and

(ii) exposures assigned to the higher credit quality steps, to which a risk weight of 150 % would normally be attributed, are assigned a risk weight of 200 %.

Article 88

1 The expected loss amounts for exposures belonging to one of the exposure classes referred to in points (a) to (e) of Article 86(1) shall be calculated in accordance with the methods set out in Annex VII, Part 1, points 29 to 35.

2 The calculation of expected loss amounts in accordance with Annex VII, Part 1, points 29 to 35 shall be based on the same input figures of PD, LGD and the exposure value for each exposure as being used for the calculation of risk-weighted exposure amounts in accordance with Article 87. For defaulted exposures, where credit institutions use own estimates of LGDs, expected loss (‘EL’) shall be the credit institution's best estimate of EL (‘EL_{BE},’) for the defaulted exposure, in accordance with Annex VII, Part 4, point 80.

3 The expected loss amounts for securitised exposures shall be calculated in accordance with Subsection 4.

4 The expected loss amount for exposures belonging to the exposure class referred to in point (g) of Article 86(1) shall be zero.

5 The expected loss amounts for dilution risk of purchased receivables shall be calculated in accordance with the methods set out in Annex VII, Part 1, point 35.

6 The expected loss amounts for exposures referred to in Article 87(11) and (12) shall be calculated in accordance with the methods set out in Annex VII, Part 1, points 29 to 35.

Article 89

1 Subject to the approval of the competent authorities, credit institutions permitted to use the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes may apply Subsection 1 for the following:

a the exposure class referred to in point (a) of Article 86(1), where the number of material counterparties is limited and it would be unduly burdensome for the credit institution to implement a rating system for these counterparties;

b the exposure class referred to in point (b) of Article 86(1), where the number of material counterparties is limited and it would be unduly burdensome for the credit institution to implement a rating system for these counterparties;

c exposures in non-significant business units as well as exposure classes that are immaterial in terms of size and perceived risk profile;

d exposures to central governments of the home Member State and to their regional governments, local authorities and administrative bodies, provided that:

(i) there is no difference in risk between the exposures to that central government and those other exposures because of specific public arrangements, and

(ii) exposures to the central government are assigned a 0 % risk weight under Subsection 1;

e exposures of a credit institution to a counterparty which is its parent undertaking, its subsidiary or a subsidiary of its parent undertaking provided that the counterparty is an institution or a financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements or an undertaking linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC and exposures between credit institutions which meet the requirements set out in Article 80(8);

f equity exposures to entities whose credit obligations qualify for a 0 % risk weight under Subsection 1 (including those publicly sponsored entities where a zero risk weight can be applied);

g equity exposures incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the credit institution and involve some form of government oversight and restrictions on the equity investments. This exclusion is limited to an aggregate of 10 % of original own funds plus additional own funds;

h the exposures identified in Annex VI, Part 1, point 40 meeting the conditions specified therein; or

i State and State-reinsured guarantees pursuant to Annex VIII, Part 2, point 19.

This paragraph shall not prevent the competent authorities of other Member States to allow the application of the rules of Subsection 1 for equity exposures which have been allowed for this treatment in other Member States.

2 For the purposes of paragraph 1, the equity exposure class of a credit institution shall be considered material if their aggregate value, excluding equity exposures incurred under legislative programmes as referred to in paragraph 1, point (g), exceeds, on average over the preceding year, 10 % of the credit institution's own funds. If the number of those equity exposures is less than 10 individual holdings, that threshold shall be 5 % of the credit institution's own funds.