

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)

[^{X1}PART THREE

CAPITAL REQUIREMENTS

TITLE II

CAPITAL REQUIREMENTS FOR CREDIT RISK

[^{X1}CHAPTER 6

Counterparty credit risk

Section 1

Definitions

Article 271

Determination of the exposure value

1 An institution shall determine the exposure value of derivative instruments listed in Annex II in accordance with this Chapter.

2 An institution may determine the exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions in accordance with this Chapter instead of making use of Chapter 4.

Article 272

Definitions

For the purposes of this Chapter and of Title VI of this Part, the following definitions shall apply:

General terms

- (1) ‘ counterparty credit risk ’ or ‘ CCR ’ means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows;

Transaction types

- (2) ‘ long settlement transactions ’ means transactions where a counterparty undertakes to deliver a security, a commodity, or a foreign exchange amount against cash, other financial instruments, or commodities, or vice versa, at a

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settlement or delivery date specified by contract that is later than the market standard for this particular type of transaction or five business days after the date on which the institution enters into the transaction, whichever is earlier;

- (3) ‘ margin lending transactions ’ means transactions in which an institution extends credit in connection with the purchase, sale, carrying or trading of securities. Margin lending transactions do not include other loans that are secured by collateral in the form of securities;

Netting set ^{F1}... and related terms

- (4) ‘ netting set ’ means a group of transactions between an institution and a single counterparty that is subject to a legally enforceable bilateral netting arrangement that is recognised under Section 7 and Chapter 4.

Each transaction that is not subject to a legally enforceable bilateral netting arrangement which is recognised under Section 7 shall be treated as its own netting set for the purposes of this Chapter.

Under the Internal Model Method set out in Section 6, all netting sets with a single counterparty may be treated as a single netting set if negative simulated market values of the individual netting sets are set to 0 in the estimation of expected exposure (hereinafter referred to as ‘ EE ’);

- (5) ^{F2} ...

- (6) ^{F3} ...

- (7) ‘ margin agreement ’ means an agreement or provisions of an agreement under which one counterparty must supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level;

- (8) ^{F4} ...

- (9) ‘ margin period of risk ’ means the time period from the most recent exchange of collateral covering a netting set of transactions with a defaulting counterparty until the transactions are closed out and the resulting market risk is re-hedged;

- (10) ‘ effective maturity ’ under the Internal Model Method for a netting set with maturity greater than one year means the ratio of the sum of expected exposure over the life of the transactions in the netting set discounted at the risk-free rate of return, divided by the sum of expected exposure over one year in the netting set discounted at the risk-free rate.

This effective maturity may be adjusted to reflect rollover risk by replacing expected exposure with effective expected exposure for forecasting horizons under one year;

- (11) ‘ cross-product netting ’ means the inclusion of transactions of different product categories within the same netting set pursuant to the cross-product netting rules set out in this Chapter;

- (12) ^{F5} ...

Distributions

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- (13) ‘ distribution of market values ’ means the forecast of the probability distribution of net market values of transactions within a netting set for a future date (the forecasting horizon), given the realised market value of those transactions at the date of the forecast;
- (14) ‘ distribution of exposures ’ means the forecast of the probability distribution of market values that is generated by setting forecast instances of negative net market values equal to zero;
- (15) ‘ risk-neutral distribution ’ means a distribution of market values or exposures over a future time period where the distribution is calculated using market implied values such as implied volatilities;
- (16) ‘ actual distribution ’ means a distribution of market values or exposures at a future time period where the distribution is calculated using historic or realised values such as volatilities calculated using past price or rate changes;

Exposure measures and adjustments

- (17) ‘ current exposure ’ means the larger of zero and the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in insolvency or liquidation;
- (18) ‘ peak exposure ’ means a high percentile of the distribution of exposures at particular future date before the maturity date of the longest transaction in the netting set;
- (19) ‘ expected exposure ’ (hereinafter referred to as ‘ EE ’) means the average of the distribution of exposures at a particular future date before the longest maturity transaction in the netting set matures;
- (20) ‘ effective expected exposure at a specific date ’ (hereinafter referred to as ‘ Effective EE ’) means the maximum expected exposure that occurs at that date or any prior date. Alternatively, it may be defined for a specific date as the greater of the expected exposure at that date or the effective expected exposure at any prior date;
- (21) ‘ expected positive exposure ’ (hereinafter referred to as ‘ EPE ’) means the weighted average over time of expected exposures, where the weights are the proportion of the entire time period that an individual expected exposure represents.

When calculating the own funds requirement, institutions shall take the average over the first year or, if all the contracts within the netting set mature within less than one year, over the time period until the contract with the longest maturity in the netting set has matured;

- (22) ‘ effective expected positive exposure ’ (hereinafter referred to as ‘ Effective EPE ’) means the weighted average of effective expected exposure over the first year of a netting set or, if all the contracts within the netting set mature within less than one year, over the time period of the longest maturity contract in the netting set, where the weights are the proportion of the entire time period that an individual expected exposure represents;

CCR related risks

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- (23) ‘ rollover risk ’ means the amount by which EPE is understated when future transactions with a counterparty are expected to be conducted on an ongoing basis.

The additional exposure generated by those future transactions is not included in calculation of EPE;

- (24) ‘ counterparty ’ for the purposes of Section 7 means any legal or natural person that enters into a netting agreement, and has the contractual capacity to do so;

- (25) ‘ contractual cross product netting agreement ’ means a bilateral contractual agreement between an institution and a counterparty which creates a single legal obligation (based on netting of covered transactions) covering all bilateral master agreements and transactions belonging to different product categories that are included within the agreement;

For the purposes of this definition, ‘ different product categories ’ means:

- (a) repurchase transactions, securities and commodities lending and borrowing transactions;
- (b) margin lending transactions;
- (c) the contracts listed in Annex II;

- (26) ^{F6} ...

Textual Amendments

- F1** Words in Art. 272 omitted (1.1.2022) by virtue of The Capital Requirements Regulation (Amendment) Regulations 2021 (S.I. 2021/1078), regs. 1(1), **6(3)(f)(i)(aa)**
- F2** Words in Art. 272(5) omitted (1.1.2022) by virtue of The Capital Requirements Regulation (Amendment) Regulations 2021 (S.I. 2021/1078), regs. 1(1), **6(3)(f)(i)(bb)**
- F3** Words in Art. 272(6) omitted (1.1.2022) by virtue of The Capital Requirements Regulation (Amendment) Regulations 2021 (S.I. 2021/1078), regs. 1(1), **6(3)(f)(i)(cc)**
- F4** Words in Art. 272(8) omitted (1.1.2022) by virtue of The Capital Requirements Regulation (Amendment) Regulations 2021 (S.I. 2021/1078), regs. 1(1), **6(3)(f)(i)(dd)**
- F5** Words in Art. 272(12) omitted (1.1.2022) by virtue of The Capital Requirements Regulation (Amendment) Regulations 2021 (S.I. 2021/1078), regs. 1(1), **6(3)(f)(i)(ee)**
- F6** Words in Art. 272(26) omitted (1.1.2022) by virtue of The Capital Requirements Regulation (Amendment) Regulations 2021 (S.I. 2021/1078), regs. 1(1), **6(3)(f)(i)(ff)**

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

Section 2

Methods for calculating the exposure value

F7 Article 273

Methods for calculating the exposure value

Textual Amendments

- F7** Art. 273 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(aa)**

Section 3

Mark-to-Market Method

F8 Article 274

Mark-to-Market Method

Textual Amendments

- F8** Art. 274 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(bb)**

Section 4

Original Exposure Method

F9 Article 275

Original Exposure Method

Textual Amendments

- F9** Art. 275 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(cc)**

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

Section 5

Standardised Method

F10 Article 276

Standardised Method

Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

F10 Article 277

Transactions with a linear risk profile

Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

F10 Article 278

Transactions with a non-linear risk profile

Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

F10 Article 279

Treatment of collateral

Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

F10 Article 279a

Supervisory delta

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Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

F10 Article 280

Calculation of risk positions

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Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

F10 Article 281

Interest rate risk positions

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Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

F10 Article 282

Hedging sets

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Textual Amendments

F10 Arts. 276-282 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(dd)**

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

Section 6

Internal Model Method

Article 283

Permission to use the Internal Model Method

1 Provided that the competent authorities are satisfied that the requirement in paragraph 2 have been met by an institution, they shall permit that institution to use the Internal Model Method (IMM) to calculate the exposure value for any of the following transactions:

- a transactions in Article 273(2)(a);
- b transactions in Article 273(2)(b), (c) and (d);
- c transactions in Article 273(2)(a) to (d),

Where an institution is permitted to use the IMM to calculate exposure value for any of the transactions mentioned in points (a) to (c) of the first subparagraph, it may also use the IMM for the transactions in Article 273(2)(e).

Notwithstanding the third subparagraph of Article 273(1), an institution may choose not to apply this method to exposures that are immaterial in size and risk. In such case, an institution shall apply one of the methods set out in [F11Sections 3 to 5 of Chapter 3 of the Counterparty Credit Risk (CRR) Part of the PRA Rulebook] to these exposures where the relevant requirements for each approach are met.

2 Competent authorities shall permit institutions to use IMM for the calculations referred to in paragraph 1 only if the institution has demonstrated that it complies with the requirements set out in this Section, and the competent authorities verified that the systems for the management of CCR maintained by the institution are sound and properly implemented.

3 The competent authorities may permit institutions for a limited period to implement the IMM sequentially across different transaction types. During this period of sequential implementation institutions may use the methods set out in [F12Sections 3 to 5 of Chapter 3 of the Counterparty Credit Risk (CRR) Part of the PRA Rulebook] for transaction type for which they do not use the IMM.

4 [F13For all OTC derivative transactions, and for long settlement transactions for which an institution has not received permission under paragraph 1 to use the IMM, the institution shall use the methods set out in [F14Section 3 of Chapter 3 of the Counterparty Credit Risk (CRR) Part of the PRA Rulebook]. Those methods may be used in combination on a permanent basis within a group.]

5 An institution which is permitted in accordance with paragraph 1 to use the IMM shall not revert to the use of the methods set out in [F15Sections 3 to 5 of Chapter 3 of the Counterparty Credit Risk (CRR) Part of the PRA Rulebook] unless it is permitted by the competent authority to do so. Competent authorities shall give such permission if the institution demonstrates good cause.

6 If an institution ceases to comply with the requirements laid down in this Section, it shall notify the competent authority and do one of the following:

- a present to the competent authority a plan for a timely return to compliance;
- b demonstrate to the satisfaction of the competent authority that the effect of non-compliance is immaterial.

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Textual Amendments

- F11** Words in Art. 283(1) substituted (1.1.2022) by The Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2021 (S.I. 2021/1376), regs. 1(3), **25(33)(a)**
- F12** Words in Art. 283(3) substituted (1.1.2022) by The Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2021 (S.I. 2021/1376), regs. 1(3), **25(33)(b)**
- F13** Art. 283(4) substituted (1.1.2022) by Financial Services Act 2021 (c. 22), s. 49(5), **Sch. 4 para. 8**; S.I. 2021/671, reg. 5(1)(c) (with reg. 5(2)) (as amended by S.I. 2021/1163, regs. 1(2), 2)
- F14** Words in Art. 283(4) substituted (1.1.2022) by The Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2021 (S.I. 2021/1376), regs. 1(3), **25(33)(c)**
- F15** Words in Art. 283(5) substituted (1.1.2022) by The Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2021 (S.I. 2021/1376), regs. 1(3), **25(33)(d)**

Article 284

Exposure value

1 Where an institution is permitted, in accordance with Article 283(1), to use the IMM to calculate the exposure value of some or all transactions mentioned in that paragraph, it shall measure the exposure value of those transactions at the level of the netting set.

The model used by the institution for that purpose shall:

- a specify the forecasting distribution for changes in the market value of the netting set attributable to joint changes in relevant market variables, such as interest rates, foreign exchange rates;
- b calculate the exposure value for the netting set at each of the future dates on the basis of the joint changes in the market variables.

2 In order for the model to capture the effects of margining, the model of the collateral value shall meet the quantitative, qualitative and data requirements for the IMM in accordance with this Section and the institution may include in its forecasting distributions for changes in the market value of the netting set only eligible financial collateral as referred to in Articles 197 and 198 and points (c) and (d) of Article 299(2).

3 The own funds requirement for counterparty credit risk with respect to the CCR exposures to which an institution applies the IMM, shall be the higher of the following:

- a the own funds requirement for those exposures calculated on the basis of Effective EPE using current market data;
- b the own funds requirement for those exposures calculated on the basis of Effective EPE using a single consistent stress calibration for all CCR exposures to which they apply the IMM.

4 Except for counterparties identified as having Specific Wrong-Way risk that fall within the scope of Article 291(4) and (5), institutions shall calculate the exposure value as the product of alpha (α) times Effective EPE, as follows:

$$\text{Exposure value} = \alpha \cdot \text{Effective EPE}$$

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where:

α = 1.4, unless competent authorities require a higher α or permit institutions to use their own estimates in accordance with paragraph 9;

Effective EPE shall be calculated by estimating expected exposure (EE) as the average exposure at future date t , where the average is taken across possible future values of relevant market risk factors.

The model shall estimate EE at a series of future dates t_1, t_2, t_3 , etc.

5 Effective EE shall be calculated recursively as:

Effective $EE_t = \max(\text{Effective } EE_{t-1}, EE_t)$

where:

the current date is denoted as t_0 ;

Effective EE_{t_0} equals current exposure.

6 Effective EPE is the average Effective EE during the first year of future exposure. If all contracts in the netting set mature within less than one year, EPE shall be the average of EE until all contracts in the netting set mature. Effective EPE shall be calculated as a weighted average of Effective EE:

[^{x2}

Effective $EPE = \frac{1}{\text{min}(1 \text{ year}, \text{maturity})} \times \sum_{k=1}^{\text{min}(1 \text{ year}, \text{maturity})} \text{Effective } EE_{t_k} \times \Delta t_k$

where the weights

$\Delta t_k = t_k - t_{k-1}$

allow for the case when future exposure is calculated at dates that are not equally spaced over time.

7 Institutions shall calculate EE or peak exposure measures on the basis of a distribution of exposures that accounts for the possible non-normality of the distribution of exposures.

8 An institution may use a measure of the distribution calculated by the IMM that is more conservative than α multiplied by Effective EPE as calculated in accordance with the equation in paragraph 4 for every counterparty.

9 Notwithstanding paragraph 4, competent authorities may permit institutions to use their own estimates of alpha, where:

- a alpha shall equal the ratio of internal capital from a full simulation of CCR exposure across counterparties (numerator) and internal capital based on EPE (denominator);
- b in the denominator, EPE shall be used as if it were a fixed outstanding amount.

When estimated in accordance with this paragraph, alpha shall be no lower than 1,2.

10 For the purposes of an estimate of alpha under paragraph 9, an institution shall ensure that the numerator and denominator are calculated in a manner consistent with the modelling methodology, parameter specifications and portfolio composition. The approach used to estimate α shall be based on the institution's internal capital approach, be well documented and be subject to independent validation. In addition, an institution shall review its estimates of alpha on at least a quarterly basis, and more frequently when the composition of the portfolio varies over time. An institution shall also assess the model risk.

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11 An institution shall demonstrate to the satisfaction of the competent authorities that its internal estimates of alpha capture in the numerator material sources of dependency of distribution of market values of transactions or of portfolios of transactions across counterparties. Internal estimates of alpha shall take account of the granularity of portfolios.

12 In supervising the use of estimates under paragraph 9, competent authorities shall have regard to the significant variation in estimates of alpha that arises from the potential for mis-specification in the models used for the numerator, especially where convexity is present.

13 Where appropriate, volatilities and correlations of market risk factors used in the joint modelling of market and credit risk shall be conditioned on the credit risk factor to reflect potential increases in volatility or correlation in an economic downturn.

Editorial Information

- X2** Substituted by [Corrigendum to Regulation \(EU\) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation \(EU\) No 648/2012 \(Official Journal of the European Union L 176 of 27 June 2013\) \(Corrected version in Official Journal of the European Union L 321 of 30 November 2013\)](#).

Article 285

Exposure value for netting sets subject to a margin agreement

1 If the netting set is subject to a margin agreement and daily mark-to-market valuation, the institution shall calculate Effective EPE as set out in this paragraph. If the model captures the effects of margining when estimating EE, the institution may, subject to the permission of the competent authority, use the model's EE measure directly in the equation in Article 284(5). Competent authorities shall grant such permission only if they verify that the model properly captures the effects of margining when estimating EE. An institution that has not received such permission shall use one of the following Effective EPE measures:

- a Effective EPE, calculated without taking into account any collateral held or posted by way of margin plus any collateral that has been posted to the counterparty independent of the daily valuation and margining process or current exposure;
- b Effective EPE, calculated as the potential increase in exposure over the margin period of risk, plus the larger of:
 - (i) the current exposure including all collateral currently held or posted, other than collateral called or in dispute;
 - (ii) the largest net exposure, including collateral under the margin agreement, that would not trigger a collateral call. This amount shall reflect all applicable thresholds, minimum transfer amounts, independent amounts and initial margins under the margin agreement.

For the purposes of point (b), institutions shall calculate the add-on as the expected positive change of the mark-to-market value of the transactions during the margin period of risk. Changes in the value of collateral shall be reflected using the Supervisory Volatility Adjustments Approach in accordance with Section 4 of Chapter 4 or the own estimates of volatility adjustments of the Financial Collateral Comprehensive Method, but no collateral payments shall be assumed during the margin period of risk. The margin period of risk is subject to the minimum periods set out in paragraphs 2 to 5.

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2 For transactions subject to daily re-margining and mark-to-market valuation, the margin period of risk used for the purpose of modelling the exposure value with margin agreements shall not be less than:

- a 5 business days for netting sets consisting only of repurchase transactions, securities or commodities lending or borrowing transactions and margin lending transactions;
- b 10 business days for all other netting sets.

3 Points (a) and (b) of paragraph 2 shall be subject to the following exceptions:

- a for all netting sets where the number of trades exceeds 5 000 at any point during a quarter, the margin period of risk for the following quarter shall not be less than 20 business days. This exception shall not apply to institutions' trade exposures;
- b for netting sets containing one or more trades involving either illiquid collateral, or an OTC derivative that cannot be easily replaced, the margin period of risk shall not be less than 20 business days.

An institution shall determine whether collateral is illiquid or whether OTC derivatives cannot be easily replaced in the context of stressed market conditions, characterised by the absence of continuously active markets where a counterparty would, within two days or fewer, obtain multiple price quotations that would not move the market or represent a price reflecting a market discount (in the case of collateral) or premium (in the case of an OTC derivative).

An institution shall consider whether trades or securities it holds as collateral are concentrated in a particular counterparty and if that counterparty exited the market precipitously whether the institution would be able to replace those trades or securities.

4 If an institution has been involved in more than two margin call disputes on a particular netting set over the immediately preceding two quarters that have lasted longer than the applicable margin period of risk under paragraphs 2 and 3, the institution shall use a margin period of risk that is at least double the period specified in paragraphs 2 and 3 for that netting set for the subsequent two quarters.

5 For re-margining with a periodicity of N days, the margin period of risk shall be at least equal to the period specified in paragraphs 2 and 3, F, plus N days minus one day. That is:

$$\text{Margin Period of Risk} = F + N - 1$$

6 If the internal model includes the effect of margining on changes in the market value of the netting set, an institution shall model collateral, other than cash of the same currency as the exposure itself, jointly with the exposure in its exposure value calculations for OTC derivatives and securities-financing transactions.

7 If an institution is not able to model collateral jointly with the exposure, it shall not recognise in its exposure value calculations for OTC derivatives and securities-financing transactions the effect of collateral other than cash of the same currency as the exposure itself, unless it uses either volatility adjustments that meet the standards of the financial collateral comprehensive Method with own volatility adjustments estimates or the standard Supervisory Volatility Adjustments Approach in accordance with Chapter 4.

8 An institution using the IMM shall ignore in its models the effect of a reduction of the exposure value due to any clause in a collateral agreement that requires receipt of collateral when counterparty credit quality deteriorates.

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Article 286

Management of CCR — Policies, processes and systems

1 An institution shall establish and maintain a CCR management framework, consisting of:

- a policies, processes and systems to ensure the identification, measurement, management, approval and internal reporting of CCR;
- b procedures for ensuring that those policies, processes and systems are complied with.

Those policies, processes and systems shall be conceptually sound, implemented with integrity and documented. The documentation shall include an explanation of the empirical techniques used to measure CCR.

2 The CCR management framework required by paragraph 1 shall take account of market, liquidity, and legal and operational risks that are associated with CCR. In particular, the framework shall ensure that the institution complies with the following principles:

- a it does not undertake business with a counterparty without assessing its creditworthiness;
- b it takes due account of settlement and pre-settlement credit risk;
- c it manages such risks as comprehensively as practicable at the counterparty level by aggregating CCR exposures with other credit exposures and at the firm-wide level.

3 An institution using the IMM shall ensure that its CCR management framework accounts to the satisfaction of the competent authority for the liquidity risks of all of the following:

- a potential incoming margin calls in the context of exchanges of variation margin or other margin types, such as initial or independent margin, under adverse market shocks;
- b potential incoming calls for the return of excess collateral posted by counterparties;
- c calls resulting from a potential downgrade of its own external credit quality assessment.

An institution shall ensure that the nature and horizon of collateral re-use is consistent with its liquidity needs and does not jeopardise its ability to post or return collateral in a timely manner.

4 An institution's management body and senior management shall be actively involved in, and ensure that adequate resources are allocated to, the management of CCR. Senior management shall be aware of the limitations and assumptions of the model used and the impact those limitations and assumptions can have on the reliability of the output through a formal process. Senior management shall be also aware of the uncertainties of the market environment and operational issues and of how these are reflected in the model.

5 The daily reports prepared on an institution's exposures to CCR in accordance with Article 287(2)(b) shall be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the institution's overall CCR exposure.

6 An institution's CCR management framework established in accordance with paragraph 1 shall be used in conjunction with internal credit and trading limits. Credit and trading limits shall be related to the institution's risk measurement model in a manner that is consistent over time and that is well understood by credit managers, traders and senior

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management. An institution shall have a formal process to report breaches of risk limits to the appropriate level of management.

7 An institution's measurement of CCR shall include measuring daily and intra-day use of credit lines. The institution shall measure current exposure gross and net of collateral. At portfolio and counterparty level, the institution shall calculate and monitor peak exposure or potential future exposure at the confidence interval chosen by the institution. The institution shall take account of large or concentrated positions, including by groups of related counterparties, by industry and by market.

8 An institution shall establish and maintain a routine and rigorous program of stress testing. The results of that stress testing shall be reviewed regularly and at least quarterly by senior management and shall be reflected in the CCR policies and limits set by the management body or senior management. Where stress tests reveal particular vulnerability to a given set of circumstances, the institution shall take prompt steps to manage those risks.

Article 287

Organisation structures for CCR management

- 1 An institution using the IMM shall establish and maintain:
 - a a risk control unit that complies with paragraph 2;
 - b a collateral management unit that complies with paragraph 3.
- 2 The risk control unit shall be responsible for the design and implementation of its CCR management, including the initial and on-going validation of the model, and shall carry out the following functions and meet the following requirements:
 - a it shall be responsible for the design and implementation of the CCR management system of the institution;
 - b it shall produce daily reports on and analyse the output of the institution's risk measurement model. That analysis shall include an evaluation of the relationship between measures of CCR exposure values and trading limits;
 - c it shall control input data integrity and produce and analyse reports on the output of the institution's risk measurement model, including an evaluation of the relationship between measures of risk exposure and credit and trading limits;
 - d it shall be independent from units responsible for originating, renewing or trading exposures and free from undue influence;
 - e it shall be adequately staffed;
 - f it shall report directly to the senior management of the institution;
 - g its work shall be closely integrated into the day-to-day credit risk management process of the institution;
 - h its output shall be an integral part of the process of planning, monitoring and controlling the institution's credit and overall risk profile.
- 3 The collateral management unit shall carry out the following tasks and functions:
 - a calculating and making margin calls, managing margin call disputes and reporting levels of independent amounts, initial margins and variation margins accurately on a daily basis;
 - b controlling the integrity of the data used to make margin calls, and ensuring that it is consistent and reconciled regularly with all relevant sources of data within the institution;

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

- c tracking the extent of re-use of collateral and any amendment of the rights of the institution to or in connection with the collateral that it posts;
- d reporting to the appropriate level of management the types of collateral assets that are reused, and the terms of such reuse including instrument, credit quality and maturity;
- e tracking concentration to individual types of collateral assets accepted by the institution;
- f reporting collateral management information on a regular basis, but at least quarterly, to senior management, including information on the type of collateral received and posted, the size, aging and cause for margin call disputes. That internal reporting shall also reflect trends in these figures.

4 Senior management shall allocate sufficient resources to the collateral management unit required under paragraph 1(b) to ensure that its systems achieve an appropriate level of operational performance, as measured by the timeliness and accuracy of margin calls by the institution and the timeliness of the response of the institution to margin calls by its counterparties. Senior management shall ensure that the unit is adequately staffed to process calls and disputes in a timely manner even under severe market crisis, and to enable the institution to limit its number of large disputes caused by trade volumes.

Article 288

Review of CCR management system

An institution shall regularly conduct an independent review of its CCR management system through its internal auditing process. That review shall include both the activities of the control and collateral management units required by Article 287 and shall specifically address, as a minimum:

- (a) the adequacy of the documentation of the CCR management system and process required by Article 286;
- (b) the organisation of the CCR control unit required by Article 287(1)(a);
- (c) the organisation of the collateral management unit required by Article 287(1)(b);
- (d) the integration of CCR measures into daily risk management;
- (e) the approval process for risk pricing models and valuation systems used by front and back-office personnel;
- (f) the validation of any significant change in the CCR measurement process;
- (g) the scope of CCR captured by the risk measurement model;
- (h) the integrity of the management information system;
- (i) the accuracy and completeness of CCR data;
- (j) the accurate reflection of legal terms in collateral and netting agreements into exposure value measurements;
- (k) the verification of the consistency, timeliness and reliability of data sources used to run models, including the independence of such data sources;
- (l) the accuracy and appropriateness of volatility and correlation assumptions;
- (m) the accuracy of valuation and risk transformation calculations;

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

- (n) the verification of the model's accuracy through frequent back-testing as set out in points (b) to (e) of Article 293(1);
- (o) the compliance of the CCR control unit and collateral management unit with the relevant regulatory requirements.

Article 289

Use test

1 Institutions shall ensure that the distribution of exposures generated by the model used to calculate Effective EPE is closely integrated into the day-to-day CCR management process of the institution, and that the output of the model is taken into account in the process of credit approval, CCR management, internal capital allocation and corporate governance.

2 The institution shall demonstrate to the satisfaction of the competent authorities that it has been using a model to calculate the distribution of exposures upon which the EPE calculation is based that meets, broadly, the requirements set out in this Section for at least one year prior to permission to use the IMM by the competent authorities in accordance with Article 283.

3 The model used to generate a distribution of exposures to CCR shall be part of the CCR management framework required by Article 286. This framework shall include the measurement of usage of credit lines, aggregating CCR exposures with other credit exposures and internal capital allocation.

4 In addition to EPE, an institution shall measure and manage current exposures. Where appropriate, the institution shall measure current exposure gross and net of collateral. The use test is satisfied if an institution uses other CCR measures, such as peak exposure, based on the distribution of exposures generated by the same model to compute EPE.

5 An institution shall have the systems capability to estimate EE daily if necessary, unless it demonstrates to the satisfaction of its competent authorities that its exposures to CCR warrant less frequent calculation. The institution shall estimate EE along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts and in a manner that is consistent with the materiality and composition of the exposures.

6 Exposure shall be measured, monitored and controlled over the life of all contracts in the netting set and not only to the one-year horizon. The institution shall have procedures in place to identify and control the risks for counterparties where the exposure rises beyond the one-year horizon. The forecast increase in exposure shall be an input into the institution's internal capital model.

Article 290

Stress testing

1 An institution shall have a comprehensive stress testing programme for CCR, including for use in assessment of own funds requirements for CCR, which complies with the requirements laid down in paragraphs 2 to 10.

2 It shall identify possible events or future changes in economic conditions that could have unfavourable effects on an institution's credit exposures and assess the institution's ability to withstand such changes.

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

3 [F16 The stress measures under the programme shall be compared against risk limits and considered by the institution as part of [F17 rule 6.1 of the Internal Capital Adequacy Part of the PRA rulebook].]

4 The programme shall comprehensively capture trades and aggregate exposures across all forms of counterparty credit risk at the level of specific counterparties in a sufficient time frame to conduct regular stress testing.

5 It shall provide for at least monthly exposure stress testing of principal market risk factors such as interest rates, FX, equities, credit spreads, and commodity prices for all counterparties of the institution, in order to identify, and enable the institution when necessary to reduce outsized concentrations in specific directional risks. Exposure stress testing -including single factor, multifactor and material non-directional risks- and joint stressing of exposure and creditworthiness shall be performed at the counterparty-specific, counterparty group and aggregate institution-wide CCR levels.

6 It shall apply at least quarterly multifactor stress testing scenarios and assess material non-directional risks including yield curve exposure and basis risks. Multiple-factor stress tests shall, at a minimum, address the following scenarios in which the following occurs:

- a severe economic or market events have occurred;
- b broad market liquidity has decreased significantly;
- c a large financial intermediary is liquidating positions.

7 The severity of the shocks of the underlying risk factors shall be consistent with the purpose of the stress test. When evaluating solvency under stress, the shocks of the underlying risk factors shall be sufficiently severe to capture historical extreme market environments and extreme but plausible stressed market conditions. The stress tests shall evaluate the impact of such shocks on own funds, own funds requirements and earnings. For the purpose of day-to-day portfolio monitoring, hedging, and management of concentrations the testing programme shall also consider scenarios of lesser severity and higher probability.

8 The programme shall include provision, where appropriate, for reverse stress tests to identify extreme, but plausible, scenarios that could result in significant adverse outcomes. Reverse stress testing shall account for the impact of material non-linearity in the portfolio.

9 The results of the stress testing under the programme shall be reported regularly, at least on a quarterly basis, to senior management. The reports and analysis of the results shall cover the largest counterparty-level impacts across the portfolio, material concentrations within segments of the portfolio (within the same industry or region), and relevant portfolio and counterparty specific trends.

10 Senior management shall take a lead role in the integration of stress testing into the risk management framework and risk culture of the institution and ensure that the results are meaningful and used to manage CCR. The results of stress testing for significant exposures shall be assessed against guidelines that indicate the institution's risk appetite, and referred to senior management for discussion and action when excessive or concentrated risks are identified.

Textual Amendments

- F16** Art. 290(3): existing wording becomes first sub-paragraph (31.12.2020) by [The Capital Requirements \(Amendment\) \(EU Exit\) Regulations 2018 \(S.I. 2018/1401\)](#), regs. 1(3), **146(a)** (with savings in S.I. 2019/680, **reg. 11**); 2020 c. 1, **Sch. 5 para. 1(1)**
- F17** Words in Art. 290(3) substituted (1.1.2022) by [Financial Services Act 2021 \(c. 22\)](#), s. 49(5), **Sch. 1 para. 34**; S.I. 2021/671, **reg. 5(1)(b)** (with **reg. 5(2)**) (as amended by S.I. 2021/1163, regs. 1(2), 2)

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

Article 291

Wrong-Way Risk

- 1 For the purposes of this Article:
 - a ‘ General Wrong-Way risk ’ arises when the likelihood of default by counterparties is positively correlated with general market risk factors;
 - b ‘ Specific Wrong-Way risk ’ arises when future exposure to a specific counterparty is positively correlated with the counterparty's PD due to the nature of the transactions with the counterparty. An institution shall be considered to be exposed to Specific Wrong-Way risk if the future exposure to a specific counterparty is expected to be high when the counterparty's probability of a default is also high.
- 2 An institution shall give due consideration to exposures that give rise to a significant degree of Specific and General Wrong-Way risk.
- 3 In order to identify General Wrong-Way risk, an institution shall design stress testing and scenario analyses to stress risk factors that are adversely related to counterparty creditworthiness. Such testing shall address the possibility of severe shocks occurring when relationships between risk factors have changed. An institution shall monitor General Wrong Way risk by product, by region, by industry, or by other categories that are relevant to the business.
- 4 An institution shall maintain procedures to identify, monitor and control cases of Specific Wrong-Way risk for each legal entity, beginning at the inception of a transaction and continuing through the life of the transaction.
- 5 Institutions shall calculate the own funds requirements for CCR in relation to transactions where Specific Wrong-Way risk has been identified and where there exists a legal connection between the counterparty and the issuer of the underlying of the OTC derivative or the underlying of the transactions referred to in points (b), (c) and (d) of Article 273(2)), in accordance with the following principles:
 - a the instruments where Specific Wrong-Way risk exists shall not be included in the same netting set as other transactions with the counterparty, and shall each be treated as a separate netting set;
 - b within any such separate netting set, for single-name credit default swaps the exposure value equals the full expected loss in the value of the remaining fair value of the underlying instruments based on the assumption that the underlying issuer is in liquidation;
 - c LGD for an institution using the approach set out in Chapter 3 shall be 100 % for such swap transactions;
 - d for an institution using the approach set out in Chapter 2 [F18 of this Regulation and Articles 132a to 132c of Chapter 3 of the Standardised Approach and Internal Ratings Based Approach to Credit Risk (CRR) Part of the PRA Rulebook], the applicable risk weight shall be that of an unsecured transaction;
 - e for all other transactions referencing a single name in any such separate netting set, the calculation of the exposure value shall be consistent with the assumption of a jump-to-default of those underlying obligations where the issuer is legally connected with the counterparty. For transactions referencing a basket of names or index, the jump-to-default of the respective underlying obligations where the issuer is legally connected with the counterparty, shall be applied, if material;

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

- f to the extent that this uses existing market risk calculations for own funds requirements for incremental default and migration risk as set out in Title IV, Chapter 5, Section 4 that already contain an LGD assumption, the LGD in the formula used shall be 100 %.

6 Institutions shall provide senior management and the appropriate committee of the management body with regular reports on both Specific and General Wrong-Way risks and the steps being taken to manage those risks.

Textual Amendments

F18 Words in Art. 291(5)(d) inserted (1.1.2022) by The Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2021 (S.I. 2021/1376), regs. 1(3), **25(34)**

Article 292

Integrity of the modelling process

1 An institution shall ensure the integrity of modelling process as set out in Article 284 by adopting at least the following measures:

- a the model shall reflect transaction terms and specifications in a timely, complete, and conservative fashion;
- b those terms shall include at least contract notional amounts, maturity, reference assets, margining arrangements and netting arrangements;
- c those terms and specifications shall be maintained in a database that is subject to formal and periodic audit;
- d a process for recognising netting arrangements that requires legal staff to verify that netting under those arrangements is legally enforceable;
- e the verification required under point (d) shall be entered into the database mentioned in point (c) by an independent unit;
- f the transmission of transaction terms and specification data to the EPE model shall be subject to internal audit;
- g there shall be processes for formal reconciliation between the model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in EPE correctly or at least conservatively.

2 Current market data shall be used to determine current exposures. An institution may calibrate its EPE model using either historic market data or market implied data to establish parameters of the underlying stochastic processes, such as drift, volatility and correlation. If an institution uses historical data, it shall use at least three years of such data. The data shall be updated at least quarterly, and more frequently if necessary to reflect market conditions.

To calculate the Effective EPE using a stress calibration, an institution shall calibrate Effective EPE using either three years of data that includes a period of stress to the credit default spreads of its counterparties or market implied data from such a period of stress.

The requirements in paragraphs 3, 4 and 5 shall be applied by the institution for that purpose.

3 An institution shall demonstrate to the satisfaction of the competent authority, at least quarterly, that the stress period used for the calculation under this paragraph coincides with a period of increased credit default swap or other credit (such as loan or corporate bond) spreads

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

for a representative selection of its counterparties with traded credit spreads. In situations where the institution does not have adequate credit spread data for a counterparty, it shall map that counterparty to specific credit spread data based on region, internal rating and business types.

4 The EPE model for all counterparties shall use data, either historic or implied, that include the data from the stressed credit period and shall use such data in a manner consistent with the method used for the calibration of the EPE model to current data.

5 To evaluate the effectiveness of its stress calibration for EEPE, an institution shall create several benchmark portfolios that are vulnerable to the main risk factors to which the institution is exposed. The exposure to these benchmark portfolios shall be calculated using (a) a stress methodology, based on current market values and model parameters calibrated to stressed market conditions, and (b) the exposure generated during the stress period, but applying the method set out in this Section (end of stress period market value, volatilities, and correlations from the 3-year stress period).

The competent authorities shall require an institution to adjust the stress calibration if the exposures of those benchmark portfolios deviate substantially from each other.

6 An institution shall subject the model to a validation process that is clearly articulated in the institutions' policies and procedures. That validation process shall:

- a specify the kind of testing needed to ensure model integrity and identify conditions under which the assumptions underlying the model are inappropriate and may therefore result in an understatement of EPE;
- b include a review of the comprehensiveness of the model.

7 An institution shall monitor the relevant risks and have processes in place to adjust its estimation of Effective EPE when those risks become significant. In complying with this paragraph, the institution shall:

- a identify and manage its exposures to Specific Wrong-Way risk arising as specified in Article 291(1)(b) and exposures to General Wrong-Way risk arising as specified in Article 291(1)(a);
- b for exposures with a rising risk profile after one year, compare on a regular basis the estimate of a relevant measure of exposure over one year with the same exposure measure over the life of the exposure;
- c for exposures with a residual maturity below one year, compare on a regular basis the replacement cost (current exposure) and the realised exposure profile, and store data that would allow such a comparison.

8 An institution shall have internal procedures to verify that, prior to including a transaction in a netting set, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in Section 7.

9 An institution that uses collateral to mitigate its CCR shall have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in Chapter 4.

F¹⁹ 10

Textual Amendments

F19 Art. 292(10) omitted (31.12.2020) by virtue of [The Capital Requirements \(Amendment\) \(EU Exit\) Regulations 2018 \(S.I. 2018/1401\)](#), regs. 1(3), **147** (with savings in S.I. 2019/680, reg. 11); 2020 c. 1, Sch. 5 para. 1(1)

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

Article 293

Requirements for the risk management system

- 1 An institution shall comply with the following requirements:
 - a it shall meet the qualitative requirements set out in Part Three, Title IV, Chapter 5;
 - b it shall conduct a regular programme of back-testing, comparing the risk measures generated by the model with realised risk measures, and hypothetical changes based on static positions with realised measures;
 - c it shall carry out an initial validation and an on-going periodic review of its CCR exposure model and the risk measures generated by it. The validation and review shall be independent of the model development;
 - d the management body and senior management shall be involved in the risk control process and shall ensure that adequate resources are devoted to credit and counterparty credit risk control. In this regard, the daily reports prepared by the independent risk control unit established in accordance Article 287(1)(a) shall be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual traders and reductions in the overall risk exposure of the institution;
 - e the internal risk measurement exposure model shall be integrated into the day-to-day risk management process of the institution;
 - f the risk measurement system shall be used in conjunction with internal trading and exposure limits. In this regard, exposure limits shall be related to the institution's risk measurement model in a manner that is consistent over time and that is well understood by traders, the credit function and senior management;
 - g an institution shall ensure that its risk management system is well documented. In particular, it shall maintain a documented set of internal policies, controls and procedures concerning the operation of the risk measurement system, and arrangements to ensure that those policies are complied with;
 - h an independent review of the risk measurement system shall be carried out regularly in the institution's own internal auditing process. This review shall include both the activities of the business trading units and of the independent risk control unit. A review of the overall risk management process shall take place at regular intervals (and no less than once a year) and shall specifically address, as a minimum, all items referred to in Article 288;
 - i the on-going validation of counterparty credit risk models, including back-testing, shall be reviewed periodically by a level of management with sufficient authority to decide the action that will be taken to address weaknesses in the models.
- 2 Competent authorities shall take into account the extent to which an institution meets the requirements of paragraph 1 when setting the level of alpha, as set out in Article 284(4). Only those institutions that comply fully with those requirements shall be eligible for application of the minimum multiplication factor.
- 3 An institution shall document the process for initial and on-going validation of its CCR exposure model and the calculation of the risk measures generated by the models to a level of detail that would enable a third party to recreate, respectively, the analysis and the risk measures. That documentation shall set out the frequency with which back testing analysis and any other on-going validation will be conducted, how the validation is conducted with respect to data flows and portfolios and the analyses that are used.

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6. (See end of Document for details)

4 An institution shall define criteria with which to assess its CCR exposure models and the models that input into the calculation of exposure and maintain a written policy that describes the process by which unacceptable performance will be identified and remedied.

5 An institution shall define how representative counterparty portfolios are constructed for the purposes of validating an CCR exposure model and its risk measures.

6 The validation of CCR exposure models and their risk measures that produce forecast distributions shall consider more than a single statistic of the forecast distribution.

Article 294

Validation requirements

1 As part of the initial and on-going validation of its CCR exposure model and its risk measures, an institution shall ensure that the following requirements are met:

- a the institution shall carry out back-testing using historical data on movements in market risk factors prior to the permission by the competent authorities in accordance with Article 283(1). That back-testing shall consider a number of distinct prediction time horizons out to at least one year, over a range of various initialisation dates and covering a wide range of market conditions;
- b the institution using the approach set out in Article 285(1)(b) shall regularly validate its model to test whether realised current exposures are consistent with prediction over all margin periods within one year. If some of the trades in the netting set have a maturity of less than one year, and the netting set has higher risk factor sensitivities without these trades, the validation shall take this into account;
- c it shall back-test the performance of its CCR exposure model and the model's relevant risk measures as well as the market risk factor predictions. For collateralised trades, the prediction time horizons considered shall include those reflecting typical margin periods of risk applied in collateralised or margined trading;
- d if the model validation indicates that Effective EPE is underestimated, the institution shall take the action necessary to address the inaccuracy of the model;
- e it shall test the pricing models used to calculate CCR exposure for a given scenario of future shocks to market risk factors as part of the initial and on-going model validation process. Pricing models for options shall account for the nonlinearity of option value with respect to market risk factors;
- f the CCR exposure model shall capture the transaction-specific information necessary to be able to aggregate exposures at the level of the netting set. An institution shall verify that transactions are assigned to the appropriate netting set within the model;
- g the CCR exposure model shall include transaction-specific information to capture the effects of margining. It shall take into account both the current amount of margin and margin that would be passed between counterparties in the future. Such a model shall account for the nature of margin agreements that are unilateral or bilateral, the frequency of margin calls, the margin period of risk, the minimum threshold of un-margined exposure the institution is willing to accept, and the minimum transfer amount. Such a model shall either estimate the mark-to-market change in the value of collateral posted or apply the rules set out in Chapter 4;
- h the model validation process shall include static, historical back-testing on representative counterparty portfolios. An institution shall conduct such back-testing on a number of representative counterparty portfolios that are actual or hypothetical at regular intervals. Those representative portfolios shall be chosen on the basis of their

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

- sensitivity to the material risk factors and combinations of risk factors to which the institution is exposed;
- i an institution shall conduct back-testing that is designed to test the key assumptions of the CCR exposure model and the relevant risk measures, including the modelled relationship between tenors of the same risk factor, and the modelled relationships between risk factors;
 - j the performance of CCR exposure models and its risk measures shall be subject to appropriate back-testing practice. The back testing programme shall be capable of identifying poor performance in an EPE model's risk measures;
 - k an institution shall validate its CCR exposure models and all risk measures out to time horizons commensurate with the maturity of trades for which exposure is calculated using IMM in accordance to the Article 283;
 - l an institution shall regularly test the pricing models used to calculate counterparty exposure against appropriate independent benchmarks as part of the on-going model validation process;
 - m the on-going validation of an institution's CCR exposure model and the relevant risk measures shall include an assessment of the adequacy of the recent performance;
 - n the frequency with which the parameters of an CCR exposure model are updated shall be assessed by an institution as part of the initial and on-going validation process;
 - o the initial and on-going validation of CCR exposure models shall assess whether or not the counterparty level and netting set exposure calculations of exposure are appropriate.
- 2 A measure that is more conservative than the metric used to calculate regulatory exposure value for every counterparty may be used in place of alpha multiplied by Effective EPE with the prior permission of the competent authorities. The degree of relative conservatism will be assessed upon initial approval by the competent authorities and at the regular supervisory reviews of the EPE models. An institution shall validate the conservatism regularly. The on-going assessment of model performance shall cover all counterparties for which the models are used.
- 3 If back-testing indicates that a model is not sufficiently accurate, the competent authorities shall revoke its permission for the model, or impose appropriate measures to ensure that the model is improved promptly.

Section 7

Contractual netting

Article 295

Recognition of contractual netting as risk-reducing

Institutions may treat as risk reducing in accordance with Article 298 only the following types of contractual netting agreements where the netting agreement has been recognised by competent authorities in accordance with Article 296 and where the institution meets the requirements set out in Article 297:

- (a) bilateral contracts for novation between an institution and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that the novation fixes one single net amount each time it applies so as to create a single new

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

- contract that replaces all former contracts and all obligations between parties pursuant to those contracts and is binding on the parties;
- (b) other bilateral agreements between an institution and its counterparty;
- (c) contractual cross-product netting agreements for institutions that have received the approval to use the method set out in Section 6 for transactions falling under the scope of that method. ^{F20} ...

Netting across transactions entered into by different legal entities of a group shall not be recognised for the purposes of calculating the own funds requirements.

Textual Amendments

F20 Words in Art. 295(c) omitted (31.12.2020) by virtue of [The Capital Requirements \(Amendment\) \(EU Exit\) Regulations 2018 \(S.I. 2018/1401\)](#), regs. 1(3), **148** (with savings in S.I. 2019/680, reg. 11); 2020 c. 1, Sch. 5 para. 1(1)

Article 296

Recognition of contractual netting agreements

- 1 Competent authorities shall recognise a contractual netting agreement only where the conditions in paragraph 2 and, where relevant, 3 are fulfilled.
- 2 The following conditions shall be fulfilled by all contractual netting agreements used by an institution for the purposes of determining exposure value in this Part:
- a the institution has concluded a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of default by the counterparty it would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;
 - b the institution has made available to the competent authorities written and reasoned legal opinions to the effect that, in the event of a legal challenge of the netting agreement, the institution's claims and obligations would not exceed those referred to in point (a). The legal opinion shall refer to the applicable law:
 - (i) the jurisdiction in which the counterparty is incorporated;
 - (ii) if a branch of an undertaking is involved, which is located in a country other than that where the undertaking is incorporated, the jurisdiction in which the branch is located;
 - (iii) the jurisdiction whose law governs the individual transactions included in the netting agreement;
 - (iv) the jurisdiction whose law governs any contract or agreement necessary to effect the contractual netting;
 - c credit risk to each counterparty is aggregated to arrive at a single legal exposure across transactions with each counterparty. This aggregation shall be factored into credit limit purposes and internal capital purposes;
 - d the contract shall not contain any clause which, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

at all, to the estate of the defaulting party, even if the defaulting party is a net creditor (i.e. walk-away clause).

If ^{F21} ... the competent authorities are not satisfied that the contractual netting is legally valid and enforceable under the law of each of the jurisdictions referred to in point (b) the contractual netting agreement shall not be recognised as risk-reducing for either of the counterparties. ^{F22} ...

3 The legal opinions referred to in point (b) may be drawn up by reference to types of contractual netting. The following additional conditions shall be fulfilled by contractual cross-product netting agreements:

- a the net sum referred to in point (a) of paragraph 2 is the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and negative mark-to-market value of the individual transactions (the ‘ cross-product net amount ’);
- b the legal opinions referred to in point (b) of paragraph 2 shall address the validity and enforceability of the entire contractual cross-product netting agreement under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreement.

Textual Amendments

- F21** Words in Art. 296(2) omitted (31.12.2020) by virtue of [The Capital Requirements \(Amendment\) \(EU Exit\) Regulations 2018 \(S.I. 2018/1401\)](#), regs. 1(3), **149(a)** (with savings in S.I. 2019/680, reg. 11); 2020 c. 1, Sch. 5 para. 1(1)
- F22** Words in Art. 296(2) omitted (31.12.2020) by virtue of [The Capital Requirements \(Amendment\) \(EU Exit\) Regulations 2018 \(S.I. 2018/1401\)](#), regs. 1(3), **149(b)** (with savings in S.I. 2019/680, reg. 11); 2020 c. 1, Sch. 5 para. 1(1)

Article 297

Obligations of institutions

1 An institution shall establish and maintain procedures to ensure that the legal validity and enforceability of its contractual netting is reviewed in the light of changes in the law of relevant jurisdictions referred to in Article 296(2)(b).

2 The institution shall maintain all required documentation relating to its contractual netting in its files.

3 The institution shall factor the effects of netting into its measurement of each counterparty's aggregate credit risk exposure and the institution shall manage its CCR on the basis of those effects of that measurement.

4 In the case of contractual cross-product netting agreements referred to in Article 295, the institution shall maintain procedures under Article 296(2)(c) to verify that any transaction which is to be included in a netting set is covered by a legal opinion referred to in Article 296(2) (b).

Taking into account the contractual cross-product netting agreement, the institution shall continue to comply with the requirements for the recognition of bilateral netting and the requirements of Chapter 4 for the recognition of credit risk mitigation, as applicable, with respect to each included individual bilateral master agreement and transaction.

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

^{F23} Article 298

Effects of recognition of netting as risk-reducing

Netting for the purposes of [^{F24}Section 6 of this Chapter, and Sections 3 to 5 of Chapter 3 of the Counterparty Credit Risk (CRR) Part of the PRA Rulebook] shall be recognised as set out in those Sections.]

Textual Amendments

- F23** Art. 298 substituted (1.1.2022) by [Financial Services Act 2021 \(c. 22\)](#), s. 49(5), **Sch. 4 para. 9**; S.I. 2021/671, reg. 5(1)(c) (with reg. 5(2)) (as amended by S.I. 2021/1163, regs. 1(2), 2)
- F24** Words in Art. 298 substituted (1.1.2022) by [The Financial Services Act 2021 \(Prudential Regulation of Credit Institutions and Investment Firms\) \(Consequential Amendments and Miscellaneous Provisions\) Regulations 2021 \(S.I. 2021/1376\)](#), regs. 1(3), **25(35)**

Section 8

Items in the trading book

Article 299

Items in the trading book

1 For the purposes of the application of this Article, Annex II shall include a reference to derivative instruments for the transfer of credit risk as mentioned in [^{F25}paragraph 8 of Part 1 of Schedule 2 to the Regulated Activities Order].

2 When calculating risk-weighted exposure amounts for counterparty risk of items in the trading book, institutions shall comply with the following principles:

- ^{F26}a
- b institutions shall not use the Financial Collateral Simple Method set out in Article 222 for the recognition of the effects of financial collateral;
- c in the case of repurchase transactions and securities or commodities lending or borrowing transactions booked in the trading book, institutions may recognise as eligible collateral all financial instruments and commodities that are eligible to be included in the trading book;
- d for exposures arising from OTC derivative instruments booked in the trading book, institutions may recognise commodities that are eligible to be included in the trading book as eligible collateral;
- e for the purposes of calculating volatility adjustments where such financial instruments or commodities which are not eligible under Chapter 4 are lent, sold or provided, or borrowed, purchased or received by way of collateral or otherwise under such a transaction, and an institution is using the Supervisory Volatility Adjustments Approach under Section 3 of Chapter 4, institutions shall treat such instruments and commodities in the same way as non-main index equities listed on a recognised exchange;
- f where an institution is using the Own Estimates of Volatility adjustments Approach under Section 3 of Chapter 4 in respect of financial instruments or commodities which

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

- are not eligible under Chapter 4, it shall calculate volatility adjustments for each individual item. Where an institution has obtained the approval to use the internal models approach defined in Chapter 4, it may also apply that approach in the trading book;
- g in relation to the recognition of master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions, institutions shall only recognise netting across positions in the trading book and the non-trading book when the netted transactions fulfil the following conditions:
- (i) all transactions are marked to market daily;
 - (ii) any items borrowed, purchased or received under the transactions may be recognised as eligible financial collateral under Chapter 4 without the application of points (c) to (f) of this paragraph;
- h where a credit derivative included in the trading book forms part of an internal hedge and the credit protection is recognised under this Regulation in accordance with Article 204, institutions shall apply one of the following approaches:
- (i) treat it as if there were no counterparty risk arising from the position in that credit derivative;
 - (ii) consistently include for the purpose of calculating the own funds requirements for counterparty credit risk all credit derivatives in the trading book forming part of internal hedges or purchased as protection against a CCR exposure where the credit protection is recognised as eligible under Chapter 4.

Textual Amendments

- F25** Words in Art. 299(1) substituted (31.12.2020) by [The Capital Requirements \(Amendment\) \(EU Exit\) Regulations 2018 \(S.I. 2018/1401\)](#), regs. 1(3), **150** (with savings in S.I. 2019/680, reg. 11); 2020 c. 1, Sch. 5 para. 1(1)
- F26** Art. 299(2)(a) omitted (1.1.2022) by virtue of [Financial Services Act 2021 \(c. 22\)](#), s. 49(5), **Sch. 4 para. 10**; S.I. 2021/671, reg. 5(1)(c) (with reg. 5(2)) (as amended by S.I. 2021/1163, regs. 1(2), 2)

Section 9

Own funds requirements for exposures to a central counterparty

^{F27} Article 300

Definitions

Textual Amendments

- F27** Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

F27 Article 301

Material scope

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Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 302

Monitoring of exposures to CCPs

.....

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 303

Treatment of clearing members' exposures to CCPs

.....

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 304

Treatment of clearing members' exposures to clients

.....

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

F27 Article 305

Treatment of clients' exposures

.....

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 306

Own funds requirements for trade exposures

.....

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 307

Own funds requirements for pre-funded contributions to the default fund of a CCP

.....

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 308

Own funds requirements for pre-funded contributions to the default fund of a QCCP

.....

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

Changes to legislation: There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 . (See end of Document for details)

F27 Article 309

Own funds requirements for pre-funded contributions to the default fund of a non-qualifying CCP and for unfunded contributions to a non-qualifying CCP

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 310

Alternative calculation of own funds requirement for exposures to a QCCP

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

F27 Article 311

Own funds requirements for exposures to CCPs that cease to meet certain conditions

Textual Amendments

F27 Arts. 300-311 omitted (1.1.2022) by virtue of [The Capital Requirements Regulation \(Amendment\) Regulations 2021 \(S.I. 2021/1078\)](#), regs. 1(1), **6(3)(f)(ii)(ee)**

Editorial Information

X1 Substituted by [Corrigendum to Regulation \(EU\) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation \(EU\) No 648/2012 \(OJ L 176, 27.6.2013, p. 1\)](#).

Changes to legislation:

There are currently no known outstanding effects for the Regulation (EU) No 575/2013 of the European Parliament and of the Council, CHAPTER 6 .