

## ANNEX VIII

### CREDIT RISK MITIGATION

#### PART 1

##### **Eligibility**

1. This part sets out eligible forms of credit risk mitigation for the purposes of Article 92.
2. For the purposes of this Annex:
  - ‘Secured lending transaction’ shall mean any transaction giving rise to an exposure secured by collateral which does not include a provision conferring upon the credit institution the right to receive margin frequently.
  - ‘Capital market-driven transaction’ shall mean any transaction giving rise to an exposure secured by collateral which includes a provision conferring upon the credit institution the right to receive margin frequently.
1. FUNDED CREDIT PROTECTION
  - 1.1. On-balance sheet netting
    3. The on-balance sheet netting of mutual claims between the credit institution and its counterparty may be recognised as eligible.
    4. Without prejudice to point 5, eligibility is limited to reciprocal cash balances between the credit institution and the counterparty. Only loans and deposits of the lending credit institution may be subject to a modification of risk-weighted exposure amounts and, as relevant, expected loss amounts as a result of an on-balance sheet netting agreement.
  - 1.2. Master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market-driven transactions
    5. For credit institutions adopting the Financial Collateral Comprehensive Method under Part 3 , the effects of bilateral netting contracts covering repurchase transactions, securities or commodities lending or borrowing transactions, and/or other capital market-driven transactions with a counterparty may be recognised. Without prejudice to Annex II to Directive 2006/49/EC to be recognised the collateral taken and securities or commodities borrowed within such agreements must comply with the eligibility requirements for collateral set out at points 7 to 11.
  - 1.3. Collateral
    6. Where the credit risk mitigation technique used relies on the right of the credit institution to liquidate or retain assets, eligibility depends upon whether risk-weighted exposure amounts, and, as relevant, expected loss amounts, are calculated under Articles 78 to 83 or Articles 84 to 89. Eligibility further depends upon whether the Financial Collateral Simple Method is used or the Financial Collateral Comprehensive Method under Part 3. In relation to repurchase transactions and securities or commodities lending or borrowing transactions, eligibility also depends upon whether the transaction is booked in the non-trading book or the trading book.
  - 1.3.1. Eligibility under all approaches and methods

---

*Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.*

---

7. The following financial items may be recognised as eligible collateral under all approaches and methods:
- (a) cash on deposit with, or cash assimilated instruments held by, the lending credit institution;
  - (b) debt securities issued by central governments or central banks, which securities have a credit assessment by an ECAI or export credit agency recognised as eligible for the purposes of Articles 78 to 83 which has been determined by the competent authority to be associated with credit quality step 4 or above under the rules for the risk weighting of exposures to central governments and central banks under Articles 78 to 83;
  - (c) debt securities issued by institutions, which securities have a credit assessment by an eligible ECAI which has been determined by the competent authority to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to credit institutions under Articles 78 to 83;
  - (d) debt securities issued by other entities, which securities have a credit assessment by an eligible ECAI which has been determined by the competent authority to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Articles 78 to 83;
  - (e) debt securities with a short-term credit assessment by an eligible ECAI which has been determined by the competent authority to be associated with credit quality step 3 or above under the rules for the risk weighting of short term exposures under Articles 78 to 83;
  - (f) equities or convertible bonds that are included in a main index; and
  - (g) gold.

For the purposes of point (b), ‘debt securities issued by central governments or central banks’ shall include:

- (i) debt securities issued by regional governments or local authorities, exposures to which are treated as exposures to the central government in whose jurisdiction they are established under Articles 78 to 83;
- (ii) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with point 15 of Part 1 of Annex VI;
- (iii) debt securities issued by multilateral development banks to which a 0 % risk weight is assigned under Articles 78 to 83; and
- (iv) debt securities issued by international organisations which are assigned a 0 % risk weight under Articles 78 to 83.

For the purposes of point (c), ‘debt securities issued by institutions’ include:

- (i) debt securities issued by regional governments or local authorities other than those exposures to which are treated as exposures to the central government in whose jurisdiction they are established under Articles 78 to 83;
- (ii) debt securities issued by public sector entities, exposures to which are treated as exposures to credit institutions under Articles 78 to 83; and

- (iii) debt securities issued by multilateral development banks other than those to which a 0 % risk weight is assigned under Articles 78 to 83.
8. Debt securities issued by institutions which securities do not have a credit assessment by an eligible ECAI may be recognised as eligible collateral if they fulfil the following criteria:
- (a) they are listed on a recognised exchange;
  - (b) they qualify as senior debt;
  - (c) all other rated issues by the issuing institution of the same seniority have a credit assessment by an eligible ECAI which has been determined by the competent authorities to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions or short term exposures under Articles 78 to 83;
  - (d) the lending credit institution has no information to suggest that the issue would justify a credit assessment below that indicated in (c); and
  - (e) the credit institution can demonstrate to the competent authorities that the market liquidity of the instrument is sufficient for these purposes.
9. Units in collective investment undertakings may be recognised as eligible collateral if the following conditions are satisfied:
- (a) they have a daily public price quote; and
  - (b) the collective investment undertaking is limited to investing in instruments that are eligible for recognition under points 7 and 8.

The use (or potential use) by a collective investment undertaking of derivative instruments to hedge permitted investments shall not prevent units in that undertaking from being eligible.

[<sup>F1</sup>If the collective investment undertaking is not limited to investing in instruments that are eligible for recognition under points 7 and 8, units may be recognised with the value of the eligible assets as collateral under the assumption that the CIU has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the credit institution shall calculate the total value of the non-eligible assets and shall reduce the value of the eligible assets by that of the non-eligible assets in case the latter is negative in total.]

#### Textual Amendments

- F1** Inserted by [Commission Directive 2009/83/EC of 27 July 2009 amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management \(Text with EEA relevance\)](#).

10. In relation to points (b) to (e) of point 7, where a security has two credit assessments by eligible ECAIs, the less favourable assessment shall be deemed to apply. In cases where a security has more than two credit assessments by eligible ECAIs, the two most favourable assessments shall be deemed to apply. If the two most favourable credit assessments are different, the less favourable of the two shall be deemed to apply.

- 1.3.2. Additional eligibility under the Financial Collateral Comprehensive Method

---

*Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.*

---

11. In addition to the collateral set out in points 7 to 10, where a credit institution uses the Financial Collateral Comprehensive Method under Part 3, the following financial items may be recognised as eligible collateral:
- (a) equities or convertible bonds not included in a main index but traded on a recognised exchange; and
  - (b) units in collective investment undertakings if the following conditions are met:
    - (i) they have a daily public price quote; and
    - (ii) the collective investment undertaking is limited to investing in instruments that are eligible for recognition under point 7 and 8 and the items mentioned in point (a) of this point.

The use (or potential use) by a collective investment undertaking of derivative instruments to hedge permitted investments shall not prevent units in that undertaking from being eligible.

[<sup>F1</sup>If the collective investment undertaking is not limited to investing in instruments that are eligible for recognition under point 7 and 8 and the items mentioned in point (a) of this point, units may be recognised with the value of the eligible assets as collateral under the assumption that the CIU has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the credit institution shall calculate the total value of the non-eligible assets and shall reduce the value of the eligible assets by that of the non-eligible assets in case the latter is negative in total.]

#### 1.3.3. Additional eligibility for calculations under Articles 84 to 89

12. In addition to the collateral set out above the provisions of points 13 to 22 apply where a credit institution calculates risk-weighted exposure amounts and expected loss amounts under the approach set out in Articles 84 to 89:
- (a) Real estate collateral
13. Residential real estate property which is or will be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, and commercial real estate property, that is, offices and other commercial premises, may be recognised as eligible collateral where the following conditions are met:
- (a) the value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower; and
  - (b) the risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.
14. Credit institutions may also recognise as eligible collateral shares in Finnish residential housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation in respect of residential property which is or will be occupied or let by the owner, as residential real estate collateral, provided that these conditions are met.

15. The competent authorities may also authorise their credit institutions to recognise as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation as commercial real estate collateral, provided that these conditions are met.
16. The competent authorities may waive the requirement for their credit institutions to comply with condition (b) in point 13 for exposures secured by residential real estate property situated within the territory of that Member State, if the competent authorities have evidence that the relevant market is well-developed and long-established with loss-rates which are sufficiently low to justify such action. This shall not prevent the competent authorities of a Member State, which do not use this waiver from recognising as eligible residential real estate property recognised as eligible in another Member State by virtue of the waiver. Member States shall disclose publicly the use they make of this waiver.
17. The competent authorities of the Member States may waive the requirement for their credit institutions to comply with the condition in point 13(b) for commercial real estate property situated within the territory of that Member State, if the competent authorities have evidence that the relevant market is well-developed and long-established and that loss-rates stemming from lending secured by commercial real estate property satisfy the following conditions:
  - (a) losses stemming from loans collateralised by commercial real estate property up to 50 % of the market value (or where applicable and if lower 60 % of the mortgage-lending-value) do not exceed 0,3 % of the outstanding loans collateralised by commercial real estate property in any given year; and
  - (b) overall losses stemming from loans collateralised by commercial real estate property do not exceed 0,5 % of the outstanding loans collateralised by commercial real estate property in any given year.
18. If either of these conditions is not satisfied in a given year, the eligibility to use this treatment will cease until the conditions are satisfied in a subsequent year.
19. The competent authorities of a Member State may recognise as eligible collateral commercial real estate property recognised as eligible collateral in another Member State by virtue of the waiver provided for in point 17.
  - (b) Receivables
20. The competent authorities may recognise as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.
  - (c) Other physical collateral
21. The competent authorities may recognise as eligible collateral physical items of a type other than those types indicated in points 13 to 19 if satisfied as to the following:
  - (a) the existence of liquid markets for disposal of the collateral in an expeditious and economically efficient manner; and
  - (b) the existence of well-established publicly available market prices for the collateral. The credit institution must be able to demonstrate that there is no evidence that the net

---

*Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.*

---

prices it receives when collateral is realised deviates significantly from these market prices.

(d) Leasing

22. Subject to the provisions of Part 3, point 72, where the requirements set out in Part 2, point 11 are met, exposures arising from transactions whereby a credit institution leases property to a third party will be treated the same as loans collateralised by the type of property leased.

1.4. Other funded credit protection

1.4.1. Cash on deposit with, or cash assimilated instruments held by, a third party institution.

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

1.4.2. Life insurance policies pledged to the lending credit institution

24. Life insurance policies pledged to the lending credit institution may be recognised as eligible credit protection.

1.4.3. Institution instruments repurchased on request

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

2. UNFUNDED CREDIT PROTECTION

2.1. Eligibility of protection providers under all approaches

26. The following parties may be recognised as eligible providers of unfunded credit protection:

(a) central governments and central banks;

(b) regional governments or local authorities;

(c) multilateral development banks;

(d) international organisations exposures to which a 0 % risk weight under Articles 78 to 83 is assigned;

(e) public sector entities, claims on which are treated by the competent authorities as claims on institutions or central governments under Articles 78 to 83;

(f) institutions; and

(g) other corporate entities, including parent, subsidiary and affiliate corporate entities of the credit institution, that:

(i) have a credit assessment by a recognised ECAI which has been determined by the competent authorities to be associated with credit quality step 2 or above under the rules for the risk weighting of exposures to corporates under Articles 78 to 83; and

(ii) in the case of credit institutions calculating risk-weighted exposure amounts and expected loss amounts under Articles 84 to 89, do not have a credit assessment by a recognised ECAI and are internally rated as having a

PD equivalent to that associated with the credit assessments of ECAIs determined by the competent authorities to be associated with credit quality step 2 or above under the rules for the risk weighting of exposures to corporate under Articles 78 to 83.

27. Where risk-weighted exposure amounts and expected loss amounts are calculated under Articles 84 to 89, to be eligible a guarantor must be internally rated by the credit institution in accordance with the provisions of Annex VII, Part 4.
28. By way of derogation from point 26, the Member States may also recognise as eligible providers of unfunded credit protection, other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of credit institutions and subject to prudential requirements equivalent to those applied to credit institutions.
- 2.2 Eligibility of protection providers under the IRB Approach which qualify for the treatment set out in Annex VII, Part 1, point 4.
29. Institutions, insurance and reinsurance undertakings and export credit agencies which fulfil the following conditions may be recognised as eligible providers of unfunded credit protection which qualify for the treatment set out in Annex VII, Part 1, point 4:
- the protection provider has sufficient expertise in providing unfunded credit protection;
  - the protection provider is regulated in a manner equivalent to the rules laid down in this Directive, or had, at the time the credit protection was provided, a credit assessment by a recognised ECAI which had been determined by the competent authorities to be associated with credit quality step 3, or above, under the rules for the risk weighting of exposures to corporate under Articles 78 to 83;
  - the protection provider had, at the time the credit protection was provided, or for any period of time thereafter, an internal rating with a PD equivalent to or lower than that associated with credit quality step 2 or above under the rules for the risk weighting of exposures to corporates under Articles 78 to 83; and
  - the provider has an internal rating with a PD equivalent to or lower than that associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Articles 78 to 83.

For the purpose of this point, credit protection provided by export credit agencies shall not benefit from any explicit central government counter-guarantee.

### 3. TYPES OF CREDIT DERIVATIVES

30. The following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, may be recognised as eligible:
- (a) credit default swaps;
  - (b) total return swaps; and
  - (c) credit linked notes to the extent of their cash funding.
31. Where a credit institution buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record offsetting deterioration in the value of the asset that is protected (either through reductions in fair value or by an addition to reserves), the credit protection shall not be recognised as eligible.

---

*Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.*

---

3.1. Internal hedges

32. When a credit institution conducts an internal hedge using a credit derivative — i.e. hedges the credit risk of an exposure in the non-trading book with a credit derivative booked in the trading book — in order for the protection to be recognised as eligible for the purposes of this Annex the credit risk transferred to the trading book shall be transferred out to a third party or parties. In such circumstances, subject to the compliance of such transfer with the requirements for the recognition of credit risk mitigation set out in this Annex, the rules set out in Parts 3 to 6 for the calculation of risk-weighted exposure amounts and expected loss amounts where unfunded credit protection is acquired shall be applied.