

PS 11/12

Financial Services Authority

Strengthening Capital Standards 3

feedback and final rules for CRD3

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Annex 1: List of non-confidential respondents

Appendix 1: Final Instrument

This Policy Statement reports on the main issues arising from Consultation Paper 11/9 (*Strengthening Capital Standards 3 – further consultation on CRD3*) and publishes final rules.

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Abbreviations used in this paper

ABCP	Asset Backed Commercial Paper
ABS	Asset Backed Security
APC	Asset Purchasing Company
APR	All Price Risk
BCBS	Basel Committee on Banking Supervision
BCD	Banking Consolidation Directive
BIPRU	Prudential sourcebook for Banks, Building Societies and Investment Firms
CBA	Cost Benefit Analysis
CEBS	Committee of European Banking Supervisors
COREP	Common Reporting Framework
CP	Commercial Paper
CP	Consultation Paper
CRD	Capital Requirements Directive
CTP	Correlation Trading Portfolio
EBA	European Banking Authority
ECAI	External Credit Assessment Institution
EC	European Commission
EEA	European Economic Area

EU	European Union
FSA	The Financial Services Authority
FSMA	Financial Services and Markets Act 2000
IDRC	Incremental Default Risk Charge
IRC	Incremental Risk Charge
IPRU (Inv)	Interim Prudential sourcebook for Investment Business
IRB	Internal Ratings Based approach to credit risk
LF	Liquidity Facility
LGD	Losses Given Default
MiFID	Markets in Financial Instruments Directive
OP	Occasional paper
PD	Probability of Default
PS	Policy Statement
PWCE	Programme Wide Credit Enhancement
RWEA	Risk Weighted Exposure Amounts
SFM	Supervisory Formula Method
SRT	Significant risk transfer
UCITS	Undertakings for Collective Investment in Transferable Securities
VaR	Value-at-Risk

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Overview

Introduction

- 1.1 This Policy Statement (PS) contains feedback on the responses to our consultation paper (CP) CP11/9 *Strengthening Capital Standards 3 – further consultation on CRD3* (chapters 2 to 4, and 6)¹, and subsequent changes to our rules. The feedback and final rules for Chapter 5 of the CP were published in Handbook Notice 112.²

Who should read this paper?

- 1.2 The contents of this PS apply principally to banks, building societies and certain investment firms that fall within the scope of the Capital Requirements Directive (CRD) (see Chapter 2 of CP09/29, scope of application), and will be of particular interest to these firms and their advisers.

Background

- 1.3 The aim of the CRD is to ensure the financial soundness of credit institutions – essentially banks and building societies and certain investment firms (collectively referred to as ‘firms’ unless stated otherwise). It stipulates the financial resources these firms must hold to cover their risks. This legal framework is being regularly updated and refined by a series of packages which the European Commission (EC) has numbered to avoid confusion and for ease of reference.
- 1.4 In CP09/29, we consulted on changes to our rules from parts of the CRD2 and CRD3 packages of amendments.³ At that stage, CRD3 was scheduled to be implemented on

1 http://www.fsa.gov.uk/pubs/cp/cp11_09.pdf

2 http://www.fsa.gov.uk/pubs/handbook/hb_notice112.pdf

3 The ‘*Strengthening Capital Standards*’ series did not consult on CRD package amendments to Remuneration or Liquidity.

1 January 2011. However, the final directive text was not published until December 2010, and the implementation date for most of the changes was set as 31 December 2011.

- 1.5 The final CRD3 text also contained changes from the early European Council version we consulted on in CP09/29 and so in CP11/9 we consulted on an updated implementation approach as well as on elements of CRD3 not included in CP09/29, provided feedback on CRD3 elements of CP09/29, and presented our proposed rules.

Structure of this PS

- 1.6 The rules and guidance included in this PS will come into force on 31 December 2011, and the changes to firms' reporting will take effect for reporting periods ending on or after that date.
- 1.7 Chapter 2 of this PS provides a summary of the responses we received to CP11/9. The rest of this paper is structured using the same chapter outline as CP11/9, as follows:
- strengthening capital requirements in the trading book (chapter 3);
 - higher capital requirements for re-securitisations (chapter 4); and
 - other CRD changes – Pillar 3, prudent valuation and technical amendments (chapter 5).
- 1.8 The cost benefit analysis is included in the relevant section rather than in a separate chapter, as in CP11/9. Changes to our reporting rules in relation to the trading book and securitisation changes are included in the relevant chapter.

Cost benefit analysis

- 1.9 CP11/9 included an extensive cost benefit analysis (CBA) of the trading book and securitisation changes. We received no new evidence from firms to change the conclusions we reached in the CBA, and do not think there will be any material increase in costs arising from the new rules, over and above those stated in the CBA. Therefore, the CBA published in CP11/9 continues to apply.

Compatibility statement

- 1.10 CP11/9 included a compatibility statement that explained why we considered our proposals to be compatible with our general duties under section 2 of the Financial Services and Markets Act 2000 (FSMA) and with our regulatory objectives, set out in sections 3 to 6 of FSMA. There have been no significant changes to the rules we proposed in that CP, or to the cost benefit analysis, and so we believe this statement is still valid.

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Summary of responses

- 2.1 We consulted on some parts of CRD3 implementation in CP09/29, and gave most of our feedback in CP10/17. In CP11/9, we consulted on the remaining elements of CRD3, as well as clarifying our approach in some areas. This PS is generally only concerned with the responses to questions in CP11/9. However, where we felt it appropriate, we have also provided feedback to some of the other comments and questions we received. Where firms have a question, that relates to how the rules specifically apply to themselves, they should contact their supervisor/FSA Firm Contact Centre. The FSA also holds regular industry fora to discuss policy issues, and firms can contact their trade body to raise issues here.
- 2.2 We received 8 responses to chapters 2 to 6 of CP11/9, for which we thank respondents.
- 2.3 Respondents generally agreed with the overall approach we have taken in putting into place the various provisions of CRD3. However, they raised some significant concerns. We have attempted to address these in our response and provide further clarification where appropriate.
- 2.4 A summary of the responses, by chapter, is provided below.

Trading Book

- 2.5 In CP11/9 we consulted further on CRD3 trading book changes in relation to our proposed trading book securitisation rules, and the guidance we provided on the capital floor to the all price risk (APR) measure and stress testing. We also consulted on proposed changes to our existing rules on securitisation credit derivatives and single-name credit derivatives.
- 2.6 The main area where respondents sought further guidance was our approach to the use of the supervisory formula method (SFM) in the trading book. We explain our strategy further in Chapter 3.
- 2.7 Respondents were generally content with the level of guidance provided in relation to capital floors and stress testing, but we have provided feedback to some detailed questions.

- 2.8 The response to the removal of our super-equivalent⁴ rules in relation to credit derivatives, and the reporting changes, was generally positive. However, we clarify some questions on the layout of the reporting forms.
- 2.9 As well as responses to the above, we also received comments on other aspects of the way in which we have put CRD3 in place, and we have provided feedback to those where appropriate.

Securitisation

- 2.10 The CRD3 securitisation changes we consulted on in CP11/9 covered re-securitisation, unfunded support, and the Committee of European Banking Supervisors⁵ (CEBS) article 122a guidelines.⁶
- 2.11 We received several responses asking for clarification on elements of the re-securitisation rules, such as what constituted 'economic substance', the treatment of exposures to asset backed commercial paper (ABCP) conduits and the application of the securitisation framework to AB loan structures.
- 2.12 Respondents were generally supportive of our rules limiting the scope of the unfunded support provisions. However, we were asked to clarify some points, including the scope of credit protection facilities that would lead to application of the unfunded support rule.
- 2.13 There were several questions on the application of the CEBS guidelines on article 122a. We have addressed these in chapter 4.

Other CRD3 changes

- 2.14 In CP11/9 we did not need to add to our consultation in CP09/29 on changes to Pillar 3, prudent valuation, or the technical amendments, and so did not seek further responses to our proposals. However, we received additional comments on Pillar 3 and prudent valuation proposals, which we have addressed in chapter 5.

Handbook text drafting

- 2.15 We are grateful for a number of suggested drafting changes to the proposed Handbook text, which we have incorporated as necessary.

⁴ meaning requiring higher standards than are required by European legislation

⁵ Now the European Banking Authority (EBA)

⁶ www.eba.europa.eu/Publications/Standards-Guidelines.aspx

Cost benefit analysis

- 2.16** A general comment from respondents was that there was insufficient information in terms of assumptions and sources of data used to comment on the trading book and securitisation cost benefit analysis (CBA) included in CP11/9. The methods by which we calculated likely impacts are detailed in our forthcoming occasional paper (OP). The inputs to this model require detailed firm-level data collected by the FSA that are commercially sensitive and which cannot be shared. We aim to be as transparent as possible in our calculations and assumptions in this OP, subject to the limits of confidentiality agreed with firms.
- 2.17** Further specific responses to the CBA questions in CP11/9 have been included in the relevant sections of the Trading Book and Securitisation chapters.

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Trading book

Introduction

- 3.1** This chapter outlines the responses received to questions related to the trading book amendments of CRD3 set out in CP11/9, our feedback to those responses and our final policy proposals.
- 3.2** The changes in CRD3 set out to:
- increase the level of capital held against trading book risks;
 - reduce the relative cyclicity of the market risk capital requirements;
 - reduce the opportunity for arbitrage between the non-trading and the trading books; and
 - improve the capture of credit risk and illiquidity in the trading book.
- 3.3** We had consulted on a number of elements of CRD3 in CP09/29. However, at the time it was published, the European parliament had yet to vote on the final CRD3 package and so the amendments and implementation date were subject to change. So, in CP11/9 we only consulted on the aspects of CRD3 that had been finalised after the publication of CP09/29; together with a reconsideration of our super-equivalent rules in the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) 7.11, the benefit of which is impacted by CRD3. In general, we took a ‘copy-out’⁷ approach to the updated elements of the CRD3 requirements.
- 3.4** In addition to addressing responses received to the specific questions set out in CP11/9, in this chapter we also provide responses to other comments received related to the trading book rule changes where we believe clarification would be of benefit to a wide range of firms. We received other comments, not related to specific questions in CP11/9, that were

⁷ That is to say that the directive text has been reproduced word for word with the minimum changes necessary to make the text fit into the rest of the Handbook.

firm specific and in these cases we have not provided a response in this PS. For these questions we recommend firms contact their supervisor for individual guidance.

3.5 Finally, in this chapter we also provide clarification on the impact of CRD3 on the following areas:

- the concentration override currently applied to incremental default risk charge (IDRC) models; and
- the applicability of CRD3 changes to Interim Prudential sourcebook for Investment Business (IPRU (Inv)) Ch 3 firms.

Stressed value at risk (VaR)

3.6 The CRD3 package will introduce a stressed VaR measure – a one-tailed 99% confidence interval 10-day VaR measure with model inputs calibrated to historical data from a continuous 12-month period of financial stress. We consulted on the draft Handbook text for this element in CP09/29 and provided feedback in CP11/9.

3.7 While we did not ask a specific question on this topic in CP11/9, we received some comments that highlighted areas where firms would benefit from further guidance on the implementation of stressed VaR.

3.8 One respondent indicated that the draft text of BIPRU 7.10.30AR suggested that the choice of the historical period used to calibrate the stressed VaR model will be subject to the FSA's approval. They requested clarification on whether the FSA intends to review and approve the methodology by which a firm selects the historical period or the chosen historical period itself.

Our response:

As part of our review of a firm's application for model approval we intend to review both the methodology through which the historical period is chosen and the resulting historical period used for calibration of the model. The main focus of the work, however, will be on the methodology applied to select the historical period.

3.9 Two respondents requested clarification on the status of the Basel Committee on Banking Supervision (BCBS) interpretative issues document, given that there are areas of divergence between the CRD3 text and the Basel Accord.

Our response:

As set out in CP11/9, the BCBS guidelines provide additional information on practical issues regarding the implementation of the market risk requirement which may be a useful source of guidance for firms but, for the avoidance of doubt, they do not constitute FSA guidance. Firms should be mindful in particular that the BCBS guidelines diverge from CRD3 in relation to certain areas, and, therefore, should avoid placing any reliance on the BCBS guidelines in relation to such areas. The forthcoming European Banking Authority (EBA) guidelines on stressed VaR should further clarify a number of interpretative issues and we recommend that firms refer to this document going forward.

The Incremental Risk Charge (IRC)

- 3.10** The IRC model aims to improve the risk capture of the market risk framework by requiring firms to hold capital for the default and migration risk of traded debt instruments incremental to that captured by their VaR model. We consulted on the draft Handbook text for this element in CP09/29 and provided feedback in CP11/9.
- 3.11** Similar to stressed VaR, as we had already consulted on the implementation of the CRD3 requirements for IRC we did not ask a specific question on this topic in CP11/9. We did however receive one response from a firm that requested clarification on the scope of positions to which the IRC requirement applies as defined in the draft rule text of BIPRU 7.10.55BR. In particular, they highlighted that the rule could more clearly indicate that the IRC only applies to positions for which interest-rate specific risk is modelled.

Our response:

Based on this, we have amended BIPRU 7.10.55BR to make it clear that the IRC measure is required only for firms granted a VaR model waiver for specific interest-rate risk.

- 3.12** Another firm raised concerns that VaR-style back-testing of the IRC model (and the APR model) was required by the draft Handbook text.

Our response:

We can confirm that VaR-style backtesting is not a specific requirement for these models. However, firms should validate the outputs of their models to confirm they are a fair reflection of the risks of their portfolios. The draft Handbook

text in BIPRU 7.10.55X, for example, requires firms to 'demonstrate through back testing or other appropriate means that its all price risk measure can appropriately explain the historical price variation of these positions'.

Applying the standardised measure to securitisations

- 3.13** The CRD3 package seeks to address the possibility for arbitrage between the non-trading and the trading book for securitisation positions by aligning the capital charges for securitisations in the trading book under the standardised method.
- 3.14** We consulted on the main aspects of this topic in CP09/29 and provided feedback in CP11/9. In CP11/9 we provided further clarification on the application of the supervisory formula method (SFM) and the final securitisation rules (including the maximum loss principle).
- Q1:** Do you require any additional guidance concerning the securitisation rules? If so, what specific aspects do you feel require attention?
- 3.15** Several respondents used this question to ask for additional guidance on the FSA's approach to the use of the SFM in the trading book. Their questions were prompted by the recent Guidance Consultation No.11/22 (GC 11/22) that set out the FSA's proposed approach to the use of the SFM in the non-trading book.
- 3.16** One respondent requested clarification on whether the correlation trading portfolio (CTP) is restricted to positions which would attract a risk weight of 1250%, and whether firms must place positions that fall within the definition of the CTP into that portfolio or whether they can choose to instead treat them as non-CTP securitisation positions.
- 3.17** Finally, one respondent asked whether the transitional provisions for the securitisation portfolio could be extended for firms who are in the process of reducing their positions.

Our response:

Although there are differences between securitisations in the non-trading book and those in the trading book, we will seek to apply an equivalent approach for the SFM across the books as far as is possible and justified in order to minimise opportunities for arbitrage. In our view, this is consistent with the general purpose of CRD3 to better align the regulatory capital treatment of securitisations in the non-trading and trading books.

In GC 11/22 we noted our significant concerns with the SFM methodology. That guidance applied to securitisations which are subject to significant risk

transfer (SRT), and since under our Handbook rules SRT does not apply in the trading book, this restricts the scope of the guidance to positions in the non-trading book. However, we have similar concerns in relation to the use of the SFM in the trading book. Therefore, we will monitor securitisation activity in the trading book closely for evidence of arbitrage and examine options for removing opportunities for arbitrage between the trading book and non-trading book. We also need to consider our approach to the use of the SFM in the calculation of the APR floor in the CTP since these positions have been explicitly carved out of a non-trading book treatment.

In order to assist us in developing our views on these issues, we have recently requested detailed information from all firms which seek to use the SFM in relation to their securitisation positions in the trading book. Firms that wish to use the SFM in the trading book but have not yet received the questionnaire should contact us as soon as possible.

In order to manage firms' expectations, we note that the EBA will be developing standards on the use of the SFM in the trading book and therefore we do not believe it is appropriate for us to produce general guidance on this matter. Until the EBA guidance is published, we may give firms individual guidance if they request it, and will continue engaging with the industry through the market risk standing group.

With respect to the CTP boundary, the CTP is not restricted to positions that would receive a 1250% risk weight under the standard rules - its definition is based on the characteristics of the positions as set out in the Handbook text. Firms can choose not to place positions that would be eligible for the CTP in that portfolio and instead treat them as non-CTP securitisations.

Finally, the transitional provisions in the draft Handbook text are a 'copy out' of the CRD3 text and are intended to ease the transition to the typically higher capital requirements resulting from the application of banking book capital charges. These provisions are not related to any expectation of a time period over which firms can exit their positions and so we do not believe it is appropriate to diverge from the CRD3 approach.

Other comments received on the draft securitisation Handbook text

- 3.18** Respondents also asked a number of questions about the draft Handbook text in this area which are summarised below, with our responses:
- BIPRU 7.2.43R(3): A respondent asked for clarification on whether a short position in a credit derivative means a short-risk position, i.e. the bank has bought protection, not that it has sold protection. We can confirm that this rule refers to short-risk positions.

We believe the rule is sufficiently clear on this point and therefore have not made any changes to the Handbook text.

- BIPRU 7.2.42AR(4): A respondent asked for this rule to be amended so that it reads ‘the positions do not **reference** a claim on a special purpose vehicle’ instead of ‘the positions do not **represent** a claim on a special purpose vehicle’. The suggested text is consistent with the directive text and we have made this change.
- BIPRU 7.2.48DR and BIPRU 7.2.48ER: A respondent asked whether firms are required to apply the 1.06 multiplier set out at BIPRU 9.12.10R. BIPRU 7.48ER states that ‘the appropriate PRA is calculated as 8% of the risk weight that would apply under the IRB approach in BIPRU 9.12.11R, subject to the requirements in BIPRU 9.12 where appropriate.’ This means that firms should apply the 1.06 multiplier, consistent with BIPRU 9.12.10R. However, the 1.06 multiplier would not apply to the standardised approach set out at BIPRU 9.2.48DR, as there is no such requirement in BIPRU 9.11.
- BIPRU 7.2.48DR and BIPRU 7.2.48ER: A respondent noted that these two tables refer to risk weights when they should refer to ‘PRA percentages’. We agree with the respondent that this change would make the table clearer and have made this change.
- BIPRU 7.2.48DR and BIPRU 7.2.48ER: A respondent suggested the following change to the tense of these Handbook rules as follows: ‘A firm may only apply the risk weights in this table where it **would have to** calculate a risk weighted exposure amount (RWEA) in accordance with the standardised approach to securitisation and re-securitisation **if such positions were** in its non-trading book under BIPRU 9.’ We agree that this change would make the text clearer and therefore have made this change.
- BIPRU 7.2.48KR: A respondent asked us to clarify whether this rule conflicts with the maximum loss principle at BIPRU 7.2.48LR (3). We can confirm that the maximum loss principle still applies for positions deducted from capital or subject to a 1250% risk weight and we have added wording the rule to clarify this.

Nth-to-default credit derivatives

- 3.19** The changes implemented by CRD3 require the capital charge for externally rated nth-to-default credit derivatives to be based on the relevant securitisation risk weighting for that rating class.
- 3.20** We did not ask a specific question on this topic in CP11/9 as it was consulted on in CP09/29. We did however receive one response from a firm that requested clarification on the treatment for the protection buyer of an nth-to-default credit derivative, as the new Handbook text at BIPRU 7.11.11 only referred to protection sellers.

Our response:

We can confirm that, as set out in BIPRU 7.11.12, the position for protection buyers should be determined as the mirror image of the treatment for protection sellers. As such the application of risk weights for protection sellers will be consistent with the treatment for protection buyers.

Correlation trading portfolio – APR, capital floor to the APR and stress testing guidance

APR/capital floor to the APR

- 3.21** In CP11/9 we incorporated into our draft Handbook text the CRD3 text, finalised after the previous consultation, which confirmed the BCBS decision that firms using the APR measure will be subject to a capital charge floor of not less than 8% of the capital charge calculated in accordance with the standardised securitisation approach, for all positions included in the APR model.
- 3.22** In calculating the standardised approach capital charge for the CTP, firms may take the larger of:
- the capital charges that would apply just to the net long positions of the correlation trading portfolio; and
 - the capital charges that would apply just to the net short positions of the correlation trading portfolio.

Q2: Would additional guidance be helpful in applying the capital floor to the APR measure? If so, what specific aspects do you feel require attention?

- 3.23** Most respondents believed that no further FSA guidance was required, although guidance at a European and global level would be helpful to ensure consistency of application. One respondent in particular raised concerns over the consistency of the floor calculation, particularly with respect to use of the SFM. The same respondent suggested benchmarking exercises should be performed to better understand the materiality of these inconsistencies. Another respondent requested clarification on the interaction between the requirement to deduct from capital resources securitisations in the trading book that would be risk weighted at 1250% in the non-trading book and the calculation of the APR floor.

Our response:

We agree that consistency of application of the APR floor is an important issue that should be addressed on a global basis. As part of our ongoing discussions in various international fora we intend to work to deliver convergence in this area. In Europe this should be aided by the intended publication of EBA guidelines on the use of IRC probabilities of defaults (PD) and loss given defaults (LGD) for the SFM. Within the UK, benchmarking exercises are being performed as part of our review of firms' APR models that aim to drive convergence in methodologies for the floor calculation as well as the APR modelling approach.

On the interaction between the requirement to deduct from capital resources securitisations in the trading book that would be risk weighted at 1250% in the non-trading book, and the calculation of the APR floor, in cases where this deduction treatment would apply the relevant securitisation should still be included in the calculation of the APR floor. If a position is 1250% risk-weighted, then it should be excluded from the calculation of maximum long and maximum short capital charges for calculating the capital charge under standard rules.

We have not made any amendments to our final rules in relation to this point.

Stress testing guidance

- 3.24** With respect to the CTP, CRD3 requires firms to regularly apply a set of predetermined stress scenarios to their APR model. The stress scenarios must consider the effect of stress-to-default rates, recovery rates, credit spreads and correlations on the profit and loss of the correlation trading desk. Firms are required to conduct these stress scenarios at least weekly and must report, on at least a quarterly basis, the results of the stress tests to the FSA.
- 3.25** We proposed to reference the Basel Guidance on stress testing the correlation trading portfolio contained in the document *Revisions to the Basel II Market Risk Framework* in our Handbook, and stated that we expected firms to use this document as the basis for their stress scenarios and internal stress testing.
- Q3:** Do you believe we should provide any further stress testing guidance for the correlation trading portfolio over and above that supplied by the BCBS? If so, what specific aspects do you feel require attention?
- 3.26** Again, most respondents believed that no further guidance was required. However, the same respondent who suggested a benchmarking exercise with respect to the APR floor also suggested a benchmarking exercise for the APR model. A further respondent requested guidance on what would constitute a 'material shortfall' in the context of the requirement to report such shortfalls to the FSA following stress tests, and whether any resulting capital add-on would be a Pillar I or Pillar II requirement.

Our response:

Based on the responses received, we have not made any changes to the draft rules. The large number of risks which the APR must capture will naturally lead to a variety of implementations. As part of our review and approval of models we will be conducting a benchmarking study using a hypothetical portfolio. This is intended to aid us in understanding the impact of different modelling choices.

BIPRU 7.11 – Securitisation credit derivatives and single-name credit derivatives

3.27 In CP11/9 we proposed to remove our BIPRU 7.11 super-equivalent securitisation credit derivative rules. These rules were originally introduced in 2007 as part of our implementation of CRD, however due to the change in the directive minimum capital requirements for securitisation credit derivatives introduced by CRD3, the cost benefit analysis no longer supported retaining the rules.

Q4: Do you believe that the FSA should retain or remove the BIPRU 7.11 rules for securitisation and single-name credit derivatives? Please provide arguments to support your response.

3.28 Most firms that responded to this question agreed with the policy decision to remove our super-equivalent rules for credit derivatives. We are grateful for the detailed input provided by several firms which helped us to make our decision.

3.29 One respondent asked whether we could amend the draft BIPRU 7.11.12CR rule in CP11/9 to make it clear which positions should be subject to the netting rules for credit derivatives rules. For example, this rule could be updated to explicitly reference those sections of the rules which deal with positions in the correlation trading portfolio, positions in the securitisation portfolio, and debt positions which are not securitisations.

Our response:

Based on the support received from respondents, the final Handbook text will remove the super-equivalent BIPRU 7.11 rules. We agree that the cross-references to the remaining netting rules in BIPRU 7.11 could be clearer and therefore we have made changes to the Handbook text to reflect this.

Those aspects of BIPRU 7.11 that are not super-equivalent to the CRD remain in that section of the Handbook.

Other trading book-related issues

Implication of CRD3 on the concentration override

- 3.30** The concentration override was introduced in 2007 by a letter from Diane Moore to the industry⁸ and was intended to act as a floor to the capital charge produced by firms' Incremental Default Risk Charge (IDRC) models. At the time this guidance was given, the standards for IDRC were not clear and so firms' approaches were required to be at least as conservative as the approach set out in the concentration override. A number of respondents have asked us whether this guidance will still apply once the IRC is introduced as part of CRD3.
- 3.31** Since the guidance requiring the concentration override was intended to address potential shortcomings due to a lack of guidance on the IDRC approach, we consider that the introduction of the IRC makes this requirement redundant. Therefore, once CRD3 comes into effect on 31 December 2011 we will no longer require firms to use an approach that is at least as conservative as the concentration override.

Application of CRD3 to IPRU (Inv) Ch 3 firms

- 3.32** IPRU (Inv) Ch 3 applies to securities and futures firms which are not MiFID investment firms or which are exempt BIPRU commodities firms. These rules allow firms to apply for permission to use internal models to calculate their market risk capital charge under IPRU (Inv) 3.80(10) and 3.169A. We have given guidance that the standards the FSA will require in a model application are the same as those we would apply under BIPRU 7.10.⁹
- 3.33** Once CRD3 comes into effect, the standards required of BIPRU firms seeking permission to use models will significantly increase. We would like to take this opportunity to clarify that firms seeking internal model permission under IPRU (Inv) Ch 3 will be subject to the revised standards applying to BIPRU firms as set out in CP09/29 and CP11/9.

Application of reverse stress testing for modelled portfolios

- 3.34** The final CRD3 text adds a requirement for firms with approval to use modelled approaches to include reverse stress testing in their stress testing programmes for their trading portfolios. One respondent requested clarification of how this should be applied in practice. Firms should consider the approach to reverse stress testing that is most relevant to their own portfolios and risk management practices. In this context firms could, for example, investigate hypothetical stresses that would produce a loss which would exceed the calculated capital resources for their modelled portfolios.

⁸ 'Update on FSA's approach to calculate default risk', 18th April 2007.

⁹ More specifically, 3.80(10) says that firms should request guidance from the FSA about the standards we will apply, and in practice we have issued individual guidance to those firms seeking waivers to the effect that BIPRU 7.10 standards will apply. 3.169A explicitly states that the 'FSA will have regard to the matters set out in BIPRU 7.10'.

Other CRD3-related changes for which no further comments were received

- 3.35 We consulted on the following areas in CP09/29 and provided feedback in CP11/9:
- improvements to VaR modelling standards; and
 - the removal of the rule allowing reduced specific risk requirements for qualifying equity positions.
- 3.36 No further comments on the draft Handbook text were received following CP11/9 and therefore no changes have been made to the draft Handbook text for these areas.

Reporting

- 3.37 In CP11/9 we proposed making a number of changes to FSA data items FSA005 and FSA058, relative to the structure set out in CP09/29, to reflect additions and amendments to the final CRD3 text. These included some material structural changes to FSA058 which were required to capture new information resulting from the final CRD3 text, and which also reflected the enhanced level of detail expected in the European Commission's Common Reporting Framework (COREP).

Q5: Are the proposed changes to FSA005 and FSA058 clear?

- 3.38 We did not receive any responses expressing concerns over the clarity of the changes to FSA005. With respect to FSA058, one respondent raised a query as to whether there was any duplication of information between FSA058 and FSA046, and in particular asked whether the fields relating to counterparty credit risk should be populated in FSA058, FSA046, or both. The same respondent requested the following clarifications:
- whether firms are required to disclose net or gross exposures in the internal ratings based (IRB) section of FSA058, and whether firms should report total exposure or whichever of the net long/net short position is driving the capital charge; and
 - whether FSA058 should be completed for positions that relate to the calculation of the APR floor.

Our response:

As no respondents requested clarification on form FSA005 we have not made any amendments to the draft rules in CP11/9.

With respect to FSA058, whilst the format of the form is designed to be similar to FSA046 the scope of positions (with FSA058 only applying to trading book positions and FSA046 applying to non-trading book positions) will naturally

mean there is no duplication of information. This also applies to the counterparty credit risk fields which should be populated only in respect of positions in the scope of the reporting form. Requiring a separate form for trading book and non-trading book exposures also reflects the extremely likely structure of reporting forms following the move to the COREP framework.

On the clarifications requested, we can confirm that net exposures should be disclosed in the IRB section of FSA058. We also confirm, as stated in CP11/9, that the CTP section of FSA058 does not need to be completed for firms that use a modelled approach for this portfolio (ie this does not need to be completed for positions that relate to the calculation of the APR floor).

We have made amendments to the forms and related guidance in our rules to reflect the above clarifications.

Cost benefit analysis

- 3.39** In CP11/9 we provided a cost benefit analysis for the complete CRD3 package for the trading book, rather than just the new and amended proposals that had not been consulted on in CP09/29.

Q14: Do you agree with the Trading Book CBA?

- 3.40** We received four responses to this question, which raised several issues for firms.
- 3.41** A number of respondents commented broadly that insufficient information provided in the CBA made it difficult for respondents to provide an informed answer, or replicate the model bank outputs. They also commented that no information was provided on the possible knock-on effects to business processes outside of the basic scope of the CP.

Our response:

The methods by which we calculated likely capital increases and asset reductions are detailed in our forthcoming occasional paper (OP). The inputs to this model require detailed firm-level data collected by the FSA that are commercially sensitive and which cannot be shared. We aim to be as transparent as possible in our calculations and assumptions in this OP, subject to the limits of confidentiality agreed with firms.

Firms operate different business models. This means that it is hard to provide accurate impacts on business processes outside the basic scope of the CP.

- 3.42 In CP11/9, para 6.52 states that *'[u]nder Pillar II we have the discretion to adjust capital levels to reflect these risks if required'*. We were asked by one respondent if that suggested we could ultimately use Pillar II to enforce whatever policy we chose. They asked if we could clarify our intention with regard the potential use of Pillar II in relation to trading book issues covered in CP11/9.

Our response:

The FSA exercises its supervisory discretion under Pillar II pursuant to GENPRU 1.2.30R. The purpose of Pillar II is to address risks not adequately covered (in whole or in part) by the Pillar I capital rules and we will apply the same principle to any review of trading book issues.

It should also be noted that in the exercise of its supervisory powers under Pillar II, the FSA is subject to the principles of good regulation in the Financial Services and Markets Act 2000 (section 2 of the Act) and to the general principles of Public law.

- 3.43 We were also asked if we, along with other regulators, had considered the cross-border costs and benefits of the current / pending regulatory changes.

Our response:

The FSA have made estimates of the holistic impact of major forthcoming banking regulation that we share with the other members of the tripartite regulatory structure. This is detailed in the forthcoming OP.

- 3.44 One respondent felt that our incremental cost of capital calculation underestimated the debt-equity spread they would face as their debt costs are significantly lower than the market average.

Our response:

The quantification of costs and benefits that we present is an average for all firms affected by policy changes and conditions over the cycle. We appreciate these will differ from firm to firm and we are pleased that individual firms are calculating the costs they are likely to experience.

4

Securitisation

Introduction

- 4.1 Chapter 3 of CP11/9 set out our proposed implementation approach to CRD2 and CRD3 changes relating to securitisation in the non-trading book. These changes can be grouped into three categories:
- re-securitisation (CRD3);
 - the use of external credit assessment institution (ECAI) credit assessments based on unfunded support (CRD3); and
 - CEBS guidelines in relation to CRD article 122a (CRD2).
- 4.2 Although there were no material changes in the final CRD3 text in respect of securitisation in the non-trading book relative to the European Council text we consulted on in CP09/29, in CP11/9 we refreshed the feedback we gave in CP10/17 and re-consulted on our implementation approach.
- 4.3 We received six responses to Chapter 3 of CP11/9 from trade associations and individual firms. We are grateful for all responses received. This chapter summarises the feedback received and sets out our responses. The final draft Handbook text is attached in Appendix 1.

Responses to questions in CP11/9

- Q6:** Do you agree with our proposed approach to implementing the CRD3 re-securitisation changes?
- 4.4 Several respondents supported the FSA's approach in determining whether an exposure meets the CRD definition of securitisation or re-securitisation based on its economic substance and also supported the view that firms should take a consistent approach to

classifying transactions. However, respondents sought clarification on the ‘economic substance’ that makes an exposure a securitisation, arguing that this would foster consistent interpretation. One respondent requested that the FSA articulate a non-exhaustive list of key features of securitisation transactions. It was argued that securitisation ordinarily involves a pool of underlying exposures that are not obligations of the originator or mere expectations of future revenues from its business and that mere tranching of obligor credit risk does not necessarily amount to securitisation. The respondent disagreed with the statement in clause 22 of the CEBS article 122a guidelines to the extent that it suggests there is no need for ‘transfer of credit risk vis-à-vis third parties’.

Our response:

The CRD definition of securitisation captures a transaction or scheme where the credit risk associated with a single exposure or pool of exposures is tranching and where payments in the transaction or scheme are dependent on the performance of exposure or pool of exposures and the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

We do not consider that the definition requires the exposures being securitised to be obligations of a third party as opposed to obligations of the originator itself. For example, a credit institution could issue covered bonds that were subsequently used as the underlying exposures of a securitisation that satisfied the CRD definition. Also, we support the statement in clause 22 of the CEBS article 122a guidelines that the CRD securitisation definition does not require the transfer of credit risk to third parties. While the transfer of credit risk to third parties may frequently be understood to be a characteristic of securitisation, the CRD definition does not require this, and it is also not the case that securitisation will necessarily transfer credit risk.

- 4.5 Respondents indicated that reference to recital 24 of CRD3 does not provide sufficiently clear guidance on how exposures to Asset Backed Commercial Paper (ABCP) conduits should be treated under the re-securitisation rules. They argued that exposures to ABCP conduits are not necessarily securitisation exposures, and generally should not be treated as re-securitisation exposures. One respondent stated that the FSA should distinguish in its policy formation between certain ABCP structures such as structured investment vehicles (SIVs) and traditional multi-seller ABCP conduits. The respondent also expressed a view that a programme-wide enhancement facility does not represent a significant tranching of economic risk of the underlying assets and consequently should not be treated as a re-securitisation exposure.

Our response:

Consistent with our general approach, we do not propose to provide Handbook guidance as to how generic transaction structures interact with the CRD and FSA Handbook definitions of securitisation and re-securitisation. This is on the basis that transactions can be structured in many different ways and even small differences in structure can impact on the assessment of whether a transaction constitutes a securitisation or re-securitisation under the definitions. But in response to the request for additional clarity, we set out below some considerations as to how the CRD definitions would typically apply to different types of position within a multi-seller ABCP programme. These considerations are specific to multi-seller ABCP programmes and should not be read as applying to other transactions or schemes that typically pool debt securities and asset backed securities (ABS) such as arbitrage conduits and SIVs.

Typical multi-seller ABCP programme structure

In an ABCP programme that invests in multiple pools of loans or receivables, each pool will typically have credit enhancement at the level of the specific asset pool (ie at the asset purchasing company (APC) level) known as 'transaction specific' credit enhancement.

ABCP conduits also frequently benefit from credit enhancement that is available to support all commercial paper (CP) issued by the conduit known as 'programme wide credit enhancement' (PWCE) and which can absorb losses stemming from any of the underlying pools of assets. It is generally the case that transaction specific credit enhancement serves as the first layer of enhancement with the PWCE only absorbing losses that exceed the transaction specific level of enhancement.

ABCP conduits also typically have liquidity facilities (LFs) to ensure timely payment of CP in circumstances where the conduit is unable to issue CP.

Treatment of transaction specific credit enhancement

We would typically consider transaction specific credit enhancement at the APC level to be a securitisation position, as it results in the tranching of the credit risk of each pool of exposures.

Treatment of programme wide credit enhancement

In the case of a multi-seller ABCP programme, it may be appropriate to consider that the various SPVs within the programme (ie the APCs and the programme conduit) are part of the same business scheme (ie if they were established at the same time or to serve the funding needs of a group of sellers). In this context, the ABCP programme as a whole could be deemed a 'securitisation' for the purposes of the CRD definition, insofar as this refers to 'schemes', as well as transactions.

In addition to the above, it would be necessary that the existence of more than one SPV (including in cases where the credit risk of each SPV is itself tranching) did not result in a material increase in the correlation risk and leverage of the scheme and that the CP issued by the programme was not tranching (as set out in recital 24 of CRD3).

Where the above premises are met, the PWCE could be deemed a securitisation position as it represents an exposure to a single scheme whereby the credit risk associated with a pool of exposures is tranching (in this case, through a combination of various SPVs).

Treatment of liquidity facilities

LFs are generally provided at the level of the APC. Given that the pool of exposures at the APC level will typically be a securitisation (by virtue of the seller enhancement resulting in the tranching of the risk of the pool) we consider that the LF will typically be an exposure to a securitisation and therefore should be considered a securitisation position.

Treatment of Commercial Paper

In circumstances where a multi-seller ABCP programme has PWCE at the conduit level that may be considered a securitisation position based on the criteria set out above, or in circumstances where there is no PWCE at the conduit level, we consider that the CP issued by a multi-seller ABCP programme will typically be an exposure to a securitisation and the CP will be a securitisation position.

- 4.6** A respondent raised concerns about the application of the CRD definition of securitisation to commercial real estate AB loan structures. Specifically, they asked that the FSA clarify that AB loan structures with certain characteristics would not be classified as securitisation exposures. Their view was that this should be the case because such structures do not involve the ‘re-packaging’ of loans; meaning the economic substance of the loans does not conform to the economic substance of a securitisation as implied by recital 24 of CRD2. They also said that if AB loan structures were captured by the definition of securitisation, the definition would, by analogy, apply to the financial indebtedness of any entity where some of its creditors had agreed that their indebtedness be subordinated. The respondent also requested confirmation that where one or more AB loans are securitised, the securitisation positions backed by the loan will not constitute ‘re-securitisation’ exposures because in their view, these positions do not involve the tranching of the credit risk of a pool of exposures containing a securitisation exposure.

Our response:

As pointed out above, we do not propose to classify how generic transaction structures interact with the CRD and FSA Handbook definitions of securitisation and re-securitisation. Transactions can be structured in many different ways and even small differences in structure can impact on the assessment of whether a transaction constitutes a securitisation or re-securitisation under the definitions.

We recognise that it is generally understood in the market that typical AB loan structures and other similar senior/mezzanine debt structures do not constitute 'securitisations'. We would agree with that view where the relevant transaction failed to meet one of the requirements in the definition of 'securitisation'. For instance, that could be the case where payments on the respective loan participations or between the senior and junior loans remain *pari passu*¹⁰ during the life of the transaction and the subordination of losses between them only kicks in upon liquidation or administration of the borrower should the commercial real estate asset default. This would be the case where the probability of default (PD) of the A and B loans was the same but the loss given default (LGD) of the loans was different. This is because the definition of securitisation requires that the subordination of tranches 'determines the distribution of losses during the on-going life of the transaction or scheme'.

However, this should not be taken as statement of general policy for all AB loan transactions and it remains primarily the responsibility of firms to assess individual AB loan structures in the light of the CRD and FSA Handbook definitions and, in particular, to consider the economic substance and not only the legal form of a transaction (BIPRU 9.1.5G).

For the avoidance of doubt, we note that we do not consider the argument that AB loan structures do not 're-package' loans to justify their exclusion from the definition of securitisation. The CRD definition does not require the 'repackaging' of loans and recital 24 of CRD2 references 'repackaging' in the context of the retention requirement only. The recital should not be read as changing the scope of the CRD definition of securitisation.

We also do not agree with the argument that treating AB loans as securitisations would have the consequential effect of bringing all financial indebtedness of an entity within the securitisation definition where some creditors were subordinated to other creditors. This is because the securitisation definition is concerned with the tranching of credit risk of an exposure or pool of exposures where the performance of the exposure or pool of exposures determines payments in the scheme or transaction. Therefore, debt instruments of different seniority with recourse to an entity as a whole, as opposed to recourse to a specific exposure or pool of exposures, would not be captured by the definition of securitisation.

Where an AB loan structure is judged not to meet the securitisation definition,

¹⁰ Have equal rights to payment

we would still consider it important that subordinated loan participations are subject to suitably prudent regulatory capital requirements to reflect their position at the bottom of the enforcement proceeds waterfall. Historic performance of commercial real estate lending indicates substantial losses suffered on subordinated loans, particularly as commercial property prices fell during 2006-2008. In light of this, we have previously requested data from firms (via the Securitisation Standing Group) on the risk weights being applied to B loans. We have not received sufficient data to give us a clear understanding of the risk weights being applied. Our understanding is that standardised firms are typically applying a 100% risk weight to B loans and that IRB firms are applying risk weights between 100-200%. In our view, the resultant level of regulatory capital being held against these positions is not commensurate with their risk and observed historic losses. We therefore intend to develop a more appropriate capital treatment of subordinated loan participations under the standardised and IRB frameworks.

We also note that even if the junior loan itself were not treated as a securitisation position, the subsequent tranching of the credit risk of the senior loan (for instance in a Commercial Mortgage Backed Security) would typically meet the definition of securitisation. Consequently, a firm would need to be able to demonstrate the achievement of significant risk transfer (SRT) via the securitisation of the senior loan in order to take capital relief. If it were unable to demonstrate SRT, the firm would be required to hold capital against the senior loan as if not securitised under the standardised or IRB framework, as appropriate.

Unfunded support

Q7: Do you agree with our proposed approach to implementing the unfunded support amendments?

- 4.7** Several respondents agreed with the FSA's decision to limit the scope of provisions on unfunded support to support which provides credit protection to a securitisation position. However, respondents asked for further clarity as to how a firm may 'justify any determination that provision of unfunded support has not resulted in credit protection to securitisation positions it holds'.
- 4.8** One respondent raised questions regarding the scope of credit protection facilities that would lead to the application of the unfunded support rule. The respondent requested confirmation that ordinary interest rate and currency hedging transactions, as well as partial liquidity facilities (of the type provided to ABS) would not cause a bank to be subject to this rule. Another respondent asked whether the self-guarantee rule would apply where the credit institution plays only one role (as an investor or facility provider, not as originator or sponsor) in the securitisation. The respondent argued that the self-guarantee

rule should not prevent a bank that provides a partial liquidity facility to an ABS transaction from using an inferred rating based on the rating of the highest-rated tranche to which the liquidity facility is fully senior, even though the liquidity facility is taken into account in rating that tranche.

Our response:

In CP11/9, we provided some guidance on the scope of the unfunded support provisions, stating that firms must consider the economic substance of a position in determining whether unfunded support has provided credit protection to a securitisation position. Despite the request for additional guidance, we do not consider it appropriate to provide an exhaustive list of positions we consider to be outside the scope of the unfunded support provisions.

First, as set out above, transactions can be structured in many different ways and, therefore, it is not appropriate for us to give general guidance on an issue that needs to be considered on a case-by-case basis. We continue to believe that a more appropriate approach is to rely on firms' own assessment of whether support provides credit enhancement to held securitisation positions based on the specific characteristics of that support.

Second, as one respondent identified, even ordinary interest rate swaps or currency swaps frequently entail some exposure to the credit risk of a transaction and contribute to the overall credit quality of the securitisation. However, unfunded support as referred to in BIPRU 9.7.2R(5) and (6) and 9.7.2AG, relates only to support that provides material credit enhancement (ie 'situations where a firm holds securitisation positions which receive a lower risk weight by virtue of unfunded credit protection provided by the firm itself acting in a different capacity in the securitisation transaction'). The need to assess materiality again justifies the need for a case by case approach and we would expect firms to take a prudent approach when making this assessment.

For these reasons, it is not possible to provide a blanket carve out from the provisions for partial liquidity facilities to ABS transactions. Firms should determine whether such facilities would be captured by the unfunded support provisions based on the criteria set out above.

However, in order to assist firms in determining whether unfunded support has provided material credit protection to a securitisation position, we offer two examples that we believe to be relatively clear in the light of the unfunded support provisions:

- i) we consider that a fixed to floating swap that does not pay on non-performing assets is unlikely to provide credit protection; and
- ii) we consider a guaranteed excess spread swap that pays on performing and non-performing assets and guarantees a level of excess spread to the

transaction regardless of senior expenses and administrative costs, is likely to provide credit protection.

Between these examples, we would expect many potential structures to exist where the determination of whether credit protection is provided is less clear. As stated previously, we expect firms to exercise judgement in these cases and consider whether the support is structured to take on material credit risk. We expect firms to be able to justify any determination made.

We agree that where the provider of support only fulfils one role in the transaction (eg as investor or support provider, not as originator or sponsor), it should not be subject to the unfunded support provisions. We believe this view is consistent with BIPRU 9.7.2AG which refers to the unfunded support rules applying in circumstances where a firm acts in multiple capacities in the securitisation transaction.

- 4.9 A respondent commented that, in a scenario where a bank uses the external rating of a liquidity facility to calculate the risk weight that should be applied to ABCP held on the balance sheet, the firm is likely to already be holding capital for the liquidity facility calculated under BIPRU 9 and thus any capital held against the held ABCP is additional. They queried whether a bank should be required to hold additional capital against any holding of ABCP supported by a liquidity facility where the firm is already holding capital against the liquidity facility; and the facility and the ABCP can be considered to overlap.

Our response:

The proposed BIPRU 9.7.4G states that a firm may be granted a waiver to allow it to use the risk weight assigned to a liquidity facility to calculate the RWEA for positions in the ACBP programme, provided the liquidity facility ranks *pari passu* with the positions in the ABCP programme so that they form overlapping positions and 100% of the ABCP issued is covered by the liquidity facilities. BIPRU 9.9.8R states that where a firm has two or more overlapping positions in a securitisation, the firm must, to the extent the positions overlap, include in its calculation of RWEA only the position, or portion of a position, producing the higher RWEA. Overlapping in this context means the positions, wholly or partially, represent an exposure to the same risk, such that to the extent of the overlap there is a single exposure.

The combination of these BIPRU provisions indicates that it is not necessary to double count the RWEA held against overlapping positions and that the RWEA for ABCP positions may, in certain circumstances, be inferred from the RWEA on the liquidity facility. However, BIPRU 9.9.8R(1) makes clear that in the case of overlapping positions, RWEA must be held against the exposure that produces the higher RWEA amount. In cases where the liquidity facility is subject to a

conversion factor of less than 100%, it is likely to be the case that the position in the ABCP has a higher RWEA requirement than the liquidity facility, meaning the firm would need to hold RWEA against the ABCP position rather than the liquidity facility. If the liquidity facility (taking into account the impact of the conversion factor) produces the same or higher RWEA as the ABCP position, and provided the other necessary criteria are met, it would be appropriate to hold regulatory capital against the liquidity facility only with no additional capital held against the ABCP positions.

Article 122a guidelines

Q8: Do you agree with our proposed approach to adopting the CEBS guidelines?

Group application

- 4.10** In CP11/9 we proposed that the requirement that subsidiary undertakings of a credit institution comply with article 122a should not apply to insurance undertakings, UK UCITS management companies or alternative investment fund managers because it is envisaged that these firms will be subject to similar requirements under other EU legislation going forward. Several respondents agreed with our approach; however one respondent questioned why reference was made to UK UCITS management companies rather than UCITS management companies (regardless of member state). Another respondent questioned the carving out of such companies from the group-level provisions, arguing that this appears to allow groups to book non-compliant positions on the balance sheets of their UCITS management subsidiaries. It was also said that reinsurance undertakings should be included in the list of excluded entities.

Our response:

We agree that the group application of article 122a should not apply to UCITS management companies (regardless of Member State) or to reinsurance undertakings. These amendments have been made to the Handbook text consulted on in CP11/9.

We continue to consider it appropriate to exclude UCITS management companies from the article 122a requirements on the basis they will be subject to equivalent requirements via other EU legislation and it is not our intention to impose duplicate requirements on firms.

We have removed the reference to 'alternative investment fund managers' from

BIPRU 9.15.16BR, pending the adoption by the EU Commission of the delegated act referred to in article 17 of directive 2011/61/EU and the transposition of the same directive in the UK.

- 4.11** In CP11/9 we recognised that, in some cases, it may not be possible for non-European Economic Area (EEA) subsidiaries within a credit institution's group to invest in securitisation positions in a way that is compliant with both the new BIPRU group level requirements and the local requirement. Consequently, we proposed to allow firms to apply for a waiver of the new BIPRU requirements in respect of non-EEA group entities in certain circumstances. One respondent expressed a view that the scope of potential waivers should include cases where inconsistent requirements between jurisdictions would make compliance unduly burdensome, as well as where there is a direct conflict between the different sets of rules.

Our response:

In paragraph 3.49 of CP11/9, we stated that we expected firms potentially to be able to satisfy the waiver statutory tests in FSMA s148 in circumstances where non-EEA group entities were subject to requirements under local law which delivered equivalent outcomes to article 122a and where the detail of the local requirements conflicted with article 122a making compliance with both requirement unduly burdensome or impossible (see also BIPRU 9.15.16DG). In order to be granted a waiver, a firm must meet the statutory tests as set out in FSMA s148 and, specifically, must be able to demonstrate that:

- (a) compliance with the rules, or with the rules as unmodified, would be unduly burdensome or would not achieve the purpose for which the rules were made; and
- (b) the waiver or modification would not result in undue risk to persons whose interests the rules are intended to protect.

It is not necessary that the rules in different jurisdictions conflict in order for a waiver to be granted. Rather, it is necessary for the firm to demonstrate that the waiver statutory tests have been met. Likewise, a conflict of rules is not by itself sufficient grounds for a firm to be granted a waiver of BIPRU 9.15.16AR unless it can demonstrate that complying with both sets of rules will be unduly burdensome to it.

Firms will have to comply fully with the group requirements under BIPRU 9.15.16AR during any period when a waiver is not in place or a waiver application is being reviewed by FSA. We will assess firms' compliance at a group level and their use of any flexibility provided by a waiver as part of our on-going supervision.

- 4.12** One respondent argued that that the requirement to ensure that an originator or sponsor did not undermine the effectiveness of retention by hedging away the retention via another entity within the group (that was not a credit institution) was an obligation falling on

investors and should not result in the group application of article 122a to originators or sponsors. Also, they argued that group application should not apply to originator and sponsor duties under paragraphs 6 and 7 of article 122a.

Our response:

Article 122a of the directive requires EU credit institutions acting as investors to invest only in securitisation positions in which the originator, sponsor or original lender has retained 5% economic interest 'on an ongoing basis'. Therefore, it is the obligation of investors to verify that, as part of the information disclosed in relation to the securitisation, the originator, sponsor or original lender has stated a commitment not to hedge away or sell the retained economic interest. We would expect EU credit institutions, when acting in the capacity of originator, sponsor or original lender, to respect the hedging restrictions on a group basis in circumstances where they expect EU credit institutions to be potential investors in their securitisation transactions. This will facilitate the effectiveness of article 122a in aligning incentives between different actors in the securitisation process and should contribute to the liquidity of the secondary market in securitisation. The proposed BIPRU 9.15.16AR, which sets out the application of article 122a requirements at group level, applies to investors only. It does not explicitly cover originators and sponsors and does not therefore require the application of paragraphs 6 and 7 of article 122a at a group level.

- 4.13 Respondents also argued for the implementation of a mutual recognition and acceptance process between the UK and non-EEA countries with respect to securitisation risk retention rules. This would involve extending the scope of potential waivers to include EEA entities exposed to the credit risk of transactions structured in compliance with another jurisdiction's risk retention rules deemed sufficiently equivalent to those of article 122a.

Our response:

We recognise the potential benefits of a mutual recognition regime between the EU risk retention requirements and risk retention requirements in third countries and we are supportive of this aim. However, as the FSA is bound by the directive, we cannot waive article 122a retention requirements to allow UK credit institutions and their EEA group entities to invest in securitisations that meet third-country risk retention requirements but not the specific EU risk retention requirements.

- 4.14 One respondent asked the FSA to clarify whether credit institutions need to seek to waive the article 122a retention requirements in circumstances where they wish to make use of the flexibility in the CEBS guidelines to potentially become exposed to non, or partially,

compliant securitisations in their non-EEA group entities when acting in a market-making capacity (as set out in clause 9 of the CEBS article 122a guidelines). Another respondent commented that industry is currently operating within the CEBS guidelines despite the waiver regime not yet being implemented. Their expectation is that a waiver would be a request to formalise existing practice and they asked the FSA to confirm this.

Our response:

It is not necessary for firms to obtain a waiver for positions held in the trading book of non-EEA group entities for which they are seeking to benefit from the flexibility provided in paragraphs 4 and 5 of article 122a. Rather, firms are required to assess the extent to which their exposure to the credit risk of any non-compliant securitisation positions is material. Where such exposure is material, or forms a large proportion of trading activity, it is likely that the requirements in paragraphs 4 and 5 will not be met in a material respect by reason of the negligence or omission of the credit institution. Clauses 8 and 9 of the CEBS guidelines set out some considerations relevant to determining the scope of the limited flexibility provided by the Directive. We do not expect firms to push the boundaries of this flexibility.

Whilst it is not necessary to obtain a waiver in order to benefit from the aforementioned Directive flexibility, the waivers regime would potentially be relevant in cases where a non-EEA group entity was subject to both article 122a and a local requirement intended to achieve similar outcomes.

- 4.15** One respondent believed that the methodology for calculating additional risk weights for non-compliance with article 122a, as set out in clauses 101 to 112 of the CEBS guidelines, should be explicitly referenced or set out in BIPRU. A respondent argued that it was important to harmonise the guidelines amongst national supervisors. It was requested that the waiver regime in respect of non-EEA group entities is made compatible with expected changes under CRD4. It was also requested that any communications between the EBA's board of supervisors and the FSA on the article 122a Guidelines be publicly disseminated in a timely manner.

Our response:

We do not intend to include a provision in BIPRU that sets out our methodology for calculating additional risk weights for non-compliance with article 122a. But, as previously set out in paragraph 3.42 of CP11/9, we can confirm that when calculating any additional risk weights to apply to a firm for material non-compliance with the directive because of negligence or omission, we will follow the methodology for calculating additional risk weights as set out in the CEBS guidelines.

We believe that our proposed approach to implementing article 122a requirements at a group level is the most appropriate approach to adopt at this time. We believe it will provide additional certainty for firms subject to retention requirements under the directive. Consistent with this, we consider it desirable that CRD4 follow a similar approach. We are aware that the European Commission draft of CRD4 (published on 20 July 2011) takes a slightly different approach to group application. But as we continue to believe that our proposed implementation approach is the most appropriate available, and given that the Commission's CRD4 draft is potentially subject to change during the negotiations, we do not consider it appropriate at this time to amend our approach.

We do not intend to publicly disseminate information on discussions held between the FSA, other EU competent authorities and the EBA in relation to the article 122a guidelines. These discussions are confidential and any decision to make public their outcome is a decision for the EBA and EU competent authorities jointly.

Application to CLOs

- 4.16 One respondent argued that the CRD should not apply (at least in its current form) to independently managed Collateralised Loan Obligations (CLOs), as these structures differ from the 'originate to distribute' model of securitisation. They stated that it has proven difficult for CLOs to find an appropriate structure, or structures, which comply with the article 122a guidelines.

Our response:

Article 122a of the CRD applies to all transactions that meet the CRD definition of securitisation. To the extent CLO transactions satisfy the definition, they are subject to article 122a. Although we acknowledge respondents' concerns regarding the application of article 122a to CLOs, the FSA cannot provide a carve-out for these transactions as doing so would be sub-equivalent to the directive. The CEBS article 122a guidelines (clauses 25. and 26. in particular) provide additional guidance in respect of the application of article 122a to CLOs and firms should refer to these provisions. But it would be necessary to amend the directive itself to exclude CLO transactions from the scope of article 122a.

Handbook amendments

Q9: Is the draft Handbook text clear? Would you find additional guidance useful? Please detail the specific areas and suggested text in your response.

4.17 Respondents asked for guidance on the following areas:

- the application of the CRD re-securitisation definition to ABCP conduits;
- unfunded credit exposures (CRD recital 31);
- calculation of additional risk weights for non-compliance with article 122a (CEBS guidelines clauses 101-103);
- waiver process for overlapping retention requirements; and
- waivers from retention for limited market-making in non-EEA affiliates.

Our response:

We acknowledge the requests for specific guidance, and have set out our position in our responses to the other questions in this Chapter.

Q10: Do you agree with our interpretation of the final CRD3 text for securitisation?

4.18 No detailed responses were received to this question, with respondents referring to the comments made in relation to other questions asked in Chapter 3 of CP11/9.

Reporting

Q11: Are the proposed changes to FSA046 clear?

4.19 One respondent expressed concern about the introduction of a number of regulatory reporting changes, requesting that the FSA limit changes to those required to fulfil supervisory objectives in respect of CRD3. The requirement to provide information on use of the concentration ratio was quoted as an example as it was argued that this approach does not change as a result of CRD3 and will not require reporting in COREP.

Our response:

We have only proposed one substantive change to FSA046 that does not relate to CRD3 implementation. Our understanding is that COREP will require data on the use of the concentration ratio, so we believe firms will be required to report this information in future. We also believe it is useful to capture such information in FSA046 as it will facilitate our identification of trends in the use of different methods for calculating capital requirements under the securitisation framework. In particular, it will improve the quality of our data on, and understanding of, the capital treatment of unrated securitisation positions by standardised firms. We also believe that it is important to be consistent in the information we collect for standardised firms relative to IRB firms and we note that FSA046 already captures information on use of the supervisory formula method which is relevant to unrated positions held by IRB firms.

Cost Benefit Analysis

Q11: Do you agree with the securitisation CBA?

- 4.20** Some respondents questioned the theoretical capital-based cost estimates of the CBA. One respondent commented that the CBA failed to quantify the cited benefits of the CEBS guidelines to article 122a, namely that they reduce regulatory arbitrage, discourage firms' exposure to inappropriate risks and reduce information asymmetries between sponsors or originators and investors.
- 4.21** One respondent urged the FSA to consider the cumulative effects of overlapping changes in regulation in different areas and by different regulators. They argued that these overlapping changes constitute a substantial burden which is likely to impede the recovery of the securities trading and securitisation markets.

Our response:

The FSA has made estimates of the cumulative effects of major forthcoming banking regulation. This is detailed in a forthcoming occasional paper (OP).

- 4.22** One respondent asked if the additional information we were requesting from firms via the reporting forms was absolutely necessary to fulfil our supervisory objectives in respect of CRD3, particularly with further changes likely from CRD4 and COREP. As an example, they provided the requirement to report concentration ratio data in FSA046.

Our response:

Please see our response in paragraph 4.19 in respect of the FSA046 changes.

Specific issues raised by firms

Supervisory Formula Method

- 4.23 Several respondents requested further guidance on the relationship between the guidance consultation¹¹ proposals on the use of the Supervisory Formula Method (SFM) in the banking book and the application of the SFM to securitisation positions in the trading book. They argued that a requirement for firms to seek external ratings for trading book derivative positions is not a realistic alternative to the SFM.

Our response:

We consider it appropriate to apply an equivalent approach for use of the SFM across the trading book and non-trading book as far as possible. This is justified in order to minimise opportunities for arbitrage and given that we have concerns with the SFM in general, irrespective of whether it is applied to positions in the trading or non-trading book.

However, the guidance consultation relates to use of the SFM by firms seeking to demonstrate SRT and BIPRU does not explicitly apply SRT to transactions originated in the trading book. So, the guidance does not apply directly to use of SFM in the trading book. But we will closely monitor securitisation activity in the trading book for evidence of arbitrage and undercapitalisation of retained positions in originated securitisation transactions. We may use our powers under Pillar 2 to correct any undercapitalisation of positions in the trading book resulting from the absence of the requirement to achieve SRT, including in circumstances where SFM has been used.

IRB firms that invest in unrated securitisation positions in either the trading or non-trading book will not be required to obtain external ratings on these positions. However, use of SFM by investors in either the trading or non-trading book requires FSA approval, and we will consider the nature of positions for which use of SFM is being sought, and the potential for SFM to generate inappropriate capital requirements for such positions, as part of our approval decision-making process.

11 The FSA issued a Guidance Consultation on the Supervisory Formula Method (SFM) and Significant Risk Transfer (SRT) on 25 May 2011. The proposed guidance states that for the purposes of assessing SRT, firms will be required, except in exceptional circumstances, to obtain a public rating on retained tranches and apply the Ratings Based Approach (RBA) instead of using the SFM.

5

Other changes

- 5.1 Our previous CRD3 publications have included proposals on several assorted changes, which we group together in this chapter. They are:
- Pillar 3;
 - Prudent valuation; and
 - Technical amendments.
- 5.2 This chapter also describes some minor corrections to references to large exposures reporting.

Pillar 3

- 5.3 In CP09/29 we consulted on implementing amendments to the Pillar 3 disclosure requirements introduced by the CRD2 and CRD3 amendment packages. We responded to the feedback we received from that consultation in CP11/9 and said that our final rules (with the exception of a minor referencing correction) would remain unchanged.
- 5.4 We received a further comment in CP11/9 that firms would benefit from formal guidance as to how we would prefer firms to publish their Pillar 3 disclosure – ie via a website, rather than in their statutory accounts.

Our response:

We believe the BIPRU 11.3.10 standard provides a level of flexibility as to where firms are expected to disclose their Pillar 3 disclosure requirements. Preferably, the disclosures should appear in one place, to enable market participants to easily track down the disclosures. The standard also clarifies that if disclosures are not made in the Pillar 3 report or the financial statements, the firm must indicate where they can be found.

Apart from some minor corrections, our final Handbook text (see appendix 1) is unchanged from that presented in CP09/29.

Prudent valuation

- 5.5 CRD3 made several changes to the prudent valuation framework, which we set out in CP09/29. We provided feedback to responses from that CP in CP10/17 and, as most respondents agreed that the CRD3 did make significant changes to existing policy, we said we would make the changes as proposed.
- 5.6 One respondent to CP11/9 raised some specific points regarding prudent valuation which we feel are best dealt with by discussions with their supervisory contact and reference to our comments on the prudent valuation framework changes in CP09/29.

Technical amendments

- 5.7 In CP09/29 we consulted on technical amendments to the CRD from both the CRD2 and CRD3 packages. The CRD2 changes were made into our rules in CP10/17. We received no comments from respondents about the CRD3 technical amendments changes proposed in CP09/29 and there were no changes to the technical amendment provisions between the European Council and Official Journal versions of the CRD3 text. Therefore, we are now making the changes to our rules, as originally proposed.
- 5.8 We will now make the changes to BIPRU 14.2.18 to implement the changed references from CRD3. Firms are reminded that the treatment of value adjustments that takes account of the credit quality of the counterparty may be subject to change under the CRD4 package. We continue our further work in light of the CRD4 proposals, for which we will consult in due course.

Large exposures reporting references

- 5.9 In Handbook notice 103 we published our final rules to introduce the CRD2 large exposures regime.
- 5.10 The changes replaced existing rules that were referenced in other parts of the Handbook, in particular SUP 16 Annex 25: guidance notes for data items in Sup 16 Annex 24R.
- 5.11 It has been brought to our attention that the references to the concentration risk capital component (CNCOM) in the guidance note to data element 103A in FSA003, and data element 5R in FSA008, incorrectly point to references pre-CRD2 rules. We have corrected these references in the final rules in Appendix 1.

Annex 1

List of non-confidential respondents

Association for Financial Markets in Europe

Barclays PLC

British Banker's Association

Commercial Real Estate Finance Council of Europe

Futures and Options Association

HSBC

Kinetic Partners LLP

Menelaus Analytics

SJ Metrics Ltd

The Loan Market Association

Appendix 1

Final Instrument

**CAPITAL REQUIREMENTS DIRECTIVE (HANDBOOK AMENDMENTS NO 4)
INSTRUMENT 2011**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 31 December 2011.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
General Prudential sourcebook (GENPRU)	Annex B
Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)	Annex C
Supervision manual (SUP)	Annex D

Notes

- E. In this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text

Citation

- F. This instrument may be cited as the Capital Requirements Directive (Handbook Amendments No 4) Instrument 2011.

By order of the Board
2 November 2011

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

<i>all price risk measure</i>	(in <i>BIPRU</i> 7.10 (Use of a Value at Risk Model)) has the meaning in <i>BIPRU</i> 7.10.116AR (Capital calculations for VaR models), which is, in relation to a <i>business day</i> , the <i>all price risk measure</i> required under the provisions in <i>BIPRU</i> 7.10 about <i>specific risk</i> for the <i>correlation trading portfolio</i> .
<i>correlation trading portfolio</i>	(in <i>BIPRU</i> 7) a portfolio consisting of <i>securitisation positions</i> and nth-to-default credit derivatives that meet the criteria set out at <i>BIPRU</i> 7.2.42AR, or other <i>positions</i> which may be included in accordance with <i>BIPRU</i> 7.2.42BR.
<i>resecuritisation position</i>	in <i>BIPRU</i> 7 and 9, an <i>exposure</i> to a <i>resecuritisation</i> .
	[Note: <i>BCD</i> , Article 4(40b)]
<i>stressed VaR</i>	The stressed VaR measure in respect of <i>positions</i> coming within the scope of the <i>VaR model permission</i> , calculated in accordance with the <i>VaR model</i> , <i>BIPRU</i> 7.10 (Use of a Value at Risk Model) and any methodology set out in the <i>VaR model permission</i> based on a stressed historical period.

Amend the following as shown.

<i>credit default swap PRR method</i>	the ordinary credit default swap PRR method or the securitisation credit default swap PRR method.
<i>clean hypothetical profit and loss figure</i>	(in <i>BIPRU</i> 7.10 (Use of a value at risk model) and in relation to a <i>business day</i>) the <i>clean</i> <i>hypothetical profit and loss figure</i> that would have occurred for that <i>business day</i> if the portfolio on which the <i>VaR number</i> for that <i>business day</i> is based remained unchanged, as more fully defined in <i>BIPRU</i> 7.10.111R (Backtesting: Hypothetical profit and loss).
<i>incremental default risk charge</i>	(in <i>BIPRU</i> 7.10 (Use of a value at risk model)) has the meaning in <i>BIPRU</i> 7.10.116R (Capital calculations for <i>VaR models</i> <u><i>VaR models</i></u>), which is in summary, in relation to a <i>business day</i> <u><i>business day</i></u> , the incremental <i>default</i> risk charge required under the provisions in <i>BIPRU</i> 7.10 about <i>specific risk</i> , in respect of the previous <i>business day's</i> close-of-business <i>positions</i> with respect to which those

provisions apply.

<i>ordinary credit default swap PRR method</i>	the method for calculating the <i>specific risk</i> portion of the <i>interest rate PRR</i> for credit default swaps that are not <i>securitisation positions</i> set out in <i>BIPRU 7.11.24R</i> to <i>BIPRU 7.11.37R</i>.
PRA	Position Risk Adjustment; a percentage applied to a <i>position</i> as part of the process of calculating the PRR in relation to that <i>position</i> as set out in the tables in <i>BIPRU 7.2.44R</i> (Specific risk PRAs), <i>BIPRU 7.2.57R</i> (General market risk PRAs), <i>BIPRU 7.3.30R</i> (Simplified equity method PRAs), <i>BIPRU 7.3.34R</i> (PRAs for specific risk under the standard equity method) and <i>BIPRU 7.6.8R</i> (The appropriate PRA) and also as set out in <i>BIPRU 7.2.46R</i> to <i>7.2.47R</i> <u><i>7.2.48AR</i> to <i>7.2.48LR</i></u> .
<i>clean profit and loss figure</i>	(in <i>BIPRU 7.10</i> (Use of a value at risk model) and in relation to a <i>business day</i>) a <i>firm's</i> actual profit or loss for that day in respect of the trading activities within the scope of the <i>firm's VaR model permission</i> , adjusted by stripping out specified items, as more fully defined in <i>BIPRU 7.10.100R</i> (Backtesting: Calculating the clean profit and loss).
<i>qualifying equity</i>	a <i>share</i> that satisfies the conditions in <i>BIPRU 7.3.35R</i> (Definition of a qualifying equity).
<i>resecuritisation</i>	(in accordance with point 49 of Part 4 of Annex IX of the <i>Banking Consolidation Directive (Ratings based method)</i>) <i>securitisation of securitisation exposures</i> (securitisation having the meaning in paragraph (2) of the definition of securitisation for these purposes) in <i>BIPRU 7</i> and <i>9</i>, a <i>securitisation</i> where the risk associated with an underlying pool of <i>exposures</i> is <i>tranch</i>ed and at least one of the underlying <i>exposures</i> is a <i>securitisation position</i>.
	[Note: <i>BCD</i>, Article 4(40a)]
<i>securitisation credit default swap PRR method</i>	the method for calculating the <i>specific risk</i> portion of the <i>interest rate PRR</i> for credit default swaps that are <i>securitisation positions</i> set out in <i>BIPRU 7.11.39R</i> to <i>BIPRU 7.11.53R</i>.

Annex B

Amendments to the General Prudential sourcebook (GENPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

- 1.3.3 G (1) In the case of a *BIPRU firm*, this section implements Article 74 of the *Banking Consolidation Directive*, ~~Article~~ Articles 64(4) and 64(5) of the *Banking Consolidation Directive* (Own funds) and Article 33 and Part B of Annex VII of the *Capital Adequacy Directive*.
- ...
- ...
- 1.3.13 R (1) Except to the extent that *GENPRU*, *BIPRU* or *INSPRU* provide for another method of valuation, *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, ~~Adjustments~~ Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves) apply:
- ...
- ...
- (3) Systems and controls under (2) must include at least the following elements:
- (a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month-end and ad-hoc verification procedures, and, in the case of a *BIPRU firm*, guidelines for the use of unobservable inputs reflecting the *firm's* assumptions of what market participants would use in pricing the *position*; and
- ...
- ...
- 1.3.16 R (1) ...
- (2) When calculating the current *exposure* value of a credit risk *exposure* for *counterparty credit risk* purposes:

...

- (b) where the difference between the more prudent side of bid/offer and the mid-market price is material, the *firm* must consider making adjustments or, in the case of an insurer or a UK ISPV, making adjustments or establishing reserves.

General requirements: Marking to model

- 1.3.17 R Where marking to market is not possible, a *firm* must (in the case of a BIPRU firm, conservatively) use mark to model in order to measure the value of the investments and positions to which this *rule* applies under *GENPRU* 1.3.13R and *GENPRU* 1.3.38R to *GENPRU* 1.3.41R. Marking to model is any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. *GENPRU* 1.3.18R to *GENPRU* 1.3.25R apply when marking to model.

...

General requirements: Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves

- 1.3.29 R The recognition of any gains or losses arising from valuations subject to *GENPRU* 1.3.13R and *GENPRU* 1.3.38R to *GENPRU* 1.3.41R must be recognised for the purpose of calculating *capital resources* in accordance with *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, Adjustments Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves). However, if *GENPRU*, *BIPRU* or *INSRU* provide for another treatment of such gains or losses, that other treatment must be applied.
- 1.3.30 R A *firm* must establish and maintain procedures for considering valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves. These procedures must be compliant with the requirements set out in *GENPRU* 1.3.33R.

...

- 1.3.32 R A *firm* must consider the need for making adjustments or, in the case of an insurer or a UK ISPV, establishing reserves for less liquid positions and, on an ongoing basis, review their continued appropriateness in accordance with the requirements set out in *GENPRU* 1.3.33R. Less liquid positions could arise from both markets events and institution-related situations e.g. concentration positions and/or stale positions.
- 1.3.33 R (1) ...
- (2) A *firm* must consider the following adjustments or, in the case of an insurer or a UK ISPV, adjustments or reserves: unearned

credit spreads, close-out costs, operational risks, early termination, investing and funding costs, future administrative costs and, where appropriate, model risk.

- (3) (a) In the case of a BIPRU firm, a firm must establish and maintain procedures for calculating adjustments to the current valuation of less liquid positions. Those adjustments must, where necessary, be in addition to any changes to the value of the position required for financial reporting purposes and must be designed to reflect the illiquidity of the position.
- (b) A firm must consider several factors when determining whether a valuation adjustment or, in the case of an insurer or a UK ISPV, valuation adjustment or reserve is necessary for less liquid positions. These factors include the amount of time it would take to hedge out the position/risks within the position; the average and volatility of bid/offer spreads; the availability of market quotes (number and identity of market makers); the average and volatility of trading volumes; market concentrations; the ageing of positions; the extent to which valuation relies on marking to model and the impact of other model risks.
- (4) With regard to complex products including, but not limited to, securitisation exposures and nth-to-default credit derivatives, a BIPRU firm must explicitly consider the need for valuation adjustments for model risk arising from using a valuation which may be incorrect or the risk from using unobservable calibration parameters in the valuation model.

- 1.3.34 R If the result of establishing making adjustments or, in the case of an insurer or a UK ISPV, making adjustments or establishing reserves under GENPRU 1.3.29R to GENPRU 1.3.33R is a valuation which differs from the fair value determined in accordance with GENPRU 1.3.4R, a firm must reconcile the two valuations.

...

Trading book and other fair-valued positions, and revaluations

...

- 1.3.39 R ~~Trading~~ Both trading book positions and other fair-valued positions are subject to prudent valuation rules as specified in GENPRU 1.3.14R to GENPRU 1.3.34R (Marking to market, Marking to model, Independent price verification, ~~Adjustments~~ Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves). In accordance with those rules, a firm must ensure that the value applied to each of its *trading book* positions and other fair-valued positions

appropriately reflects the current market value. This value must contain an appropriate degree of certainty having regard to the dynamic nature of *trading book* positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of *trading book* positions and other fair-valued positions.

...

- 1.3.41 R (1) For the purposes of *GENPRU* and *INSPRU*, an *insurer* or a *UK ISPV* must apply *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, ~~Adjustments~~ Valuation adjustments or, in the case of an *insurer* or a *UK ISPV*, valuation adjustments or reserves) to account for:

...

...

...

- 2.2.237 R A *BIPRU* firm calculating *risk weighted exposure amounts* under the *IRB approach* or the *standardised approach* to credit risk must deduct from its capital resources the ~~exposure amount of securitisation positions which receive a risk weight of 1250% under BIPRU 9 (Securitisation), unless the firm includes the securitisation positions in its calculation of risk weighted exposure amounts (see BIPRU 9.10 (Reduction in risk-weighted exposure amounts))~~ following:

- (1) the exposure amount of *securitisation positions* which receive a *risk weight* of 1250% under *BIPRU* 9 (Securitisation), unless the *firm* includes the *securitisation positions* in its calculation of *risk weighted exposure amounts* (see *BIPRU* 9.10 (Reduction in risk-weighted exposure amounts)); and
- (2) the exposure amount of *securitisation positions* in the *trading book* that would receive a *risk weight* of 1250% if they were in the *firm's non-trading book*.

Annex C

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Exposures to regional governments or local authorities: General

- 3.4.10 R Without prejudice to *BIPRU* 3.4.15R to *BIPRU* 3.4.19R:
- (1) a firm must *risk weight exposures* to regional governments and local authorities in accordance with *BIPRU* 3.4.11R to *BIPRU* 3.4.14R and *BIPRU* 3.4.19AR; and

...

...

- 3.4.19A R Without prejudice to *BIPRU* 3.4.17R to *BIPRU* 3.4.19R, an *exposure* to a regional government or local authority of an *EEA State* denominated and funded in the domestic currency of that regional government or local authority must be assigned a risk weight of 20%.

[**Note:** *BCD* Annex VI Part 2(b)]

...

Deriving the net position in the correlation trading portfolio

- 7.2.42A R A correlation trading portfolio may only consist of *securitisation positions* and *nth-to-default credit derivatives* that meet the following criteria:
- (1) the *positions* are neither *resecuritisation positions*, nor *options* on a *securitisation position*, nor any other derivatives of *securitisation exposures* that do not provide a pro-rata share in the proceeds of a *securitisation tranche*;
- (2) all reference instruments are either *single-name instruments*, including *single-name credit derivatives*, for which a liquid two-way market exists, or commonly traded indices based on reference entities which meet this criterion;
- (3) the *positions* do not fall under the exposure classes outlined in *BIPRU* 3.2.9R(8) (retail claims or contingent retail claims) and *BIPRU* 3.2.9R(9) (claims or contingent claims secured on real estate property); and

- (4) the *positions* do not reference a claim on a *special purpose vehicle*.
- 7.2.42B R *Positions* which are not *securitisation positions* or *nth-to-default credit derivatives* may be included in the *correlation trading portfolio* only if they hedge other such *positions* in this portfolio and a liquid two-way market exists for the relevant *position* or its reference entities.
- 7.2.42C R For the purposes of *BIPRU 7.2.42AR(2)* and *BIPRU 7.2.42BR*, a two-way market may be deemed to exist only where there are independent, bona fide offers to buy and sell, so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one *business day* and settled at that price within a relatively short time conforming to trade custom.
- 7.2.42D R A *firm* must calculate both the net long and the net short *positions* in the *correlation trading portfolio* by applying *BIPRU 7.2.36R* and *BIPRU 7.2.37R* or, where applicable, *BIPRU 7.11.13R* to *BIPRU 7.11.17R*.

Specific risk calculation

- 7.2.43 R (1) A *firm* must calculate the *specific risk* portion of the *interest rate PRR* for each debt *security* by multiplying the market value of the individual net *position* (ignoring the sign) by the *appropriate PRA* from the table in *BIPRU 7.2.44R* or as specified by *BIPRU 7.2.45R* – ~~*BIPRU 7.2.47R*~~ *7.2.48LR* or by ~~*BIPRU 7.11.13R*~~ – *BIPRU 7.11.17R*.
- ...
- (3) For the purpose of (1), a *firm* may cap the product of multiplying the individual net *position* by the *appropriate PRA* at the maximum possible default-risk-related loss. For a short *position* in a credit derivative, a *firm* may calculate the maximum possible default-risk-related loss as a change in value due to the underlying names immediately becoming default-risk-free.
- ...
- 7.2.46A G *BIPRU 7.2.43R* includes both actual and notional *positions*. However, notional *positions* in a *zero-specific-risk security* do not attract *specific risk*. For example:
- (1) *interest-rate swaps, foreign currency swaps, FRAs, interest-rate futures, foreign-currency forwards, foreign-currency futures, and the cash leg of repurchase agreements and reverse repurchase agreements* create notional *positions* which will not attract *specific risk*; while

- (2) futures, forwards and swaps which are based on the price (or yield) of one or more debt *securities* will create at least one notional *position* that attracts *specific risk*.

Specific risk: securitisations and resecuritisations

- 7.2.47 R ~~A *securitisation exposures* that would be subject to a deduction treatment under the treatment set out in *GENPRU 2.2*. (Capital resources) or *risk weighted* at 1250% as set out in *BIPRU 9* (Securitisation) is subject to a capital charge that is no less than that set out under those treatments. Unrated liquidity facilities are subject to a capital charge that is no less than that set out in *BIPRU 9*. [deleted]~~
- 7.2.47A G ~~*Originators, investors and sponsors* of *securitisations* in the *trading book* will have to meet the requirements of *BIPRU 9.3.1AR*, *BIPRU 9.3.15R* to *BIPRU 9.3.20R* and *BIPRU 9.15*. [deleted]~~
- 7.2.47B G ~~Subject to *BIPRU 7.2.47CG*, *BIPRU 9.15.9R* and *BIPRU 9.15.10R*, where the investor, *originator* or *sponsor* of a *securitisation* fails to meet any of the requirements in *BIPRU 9.3.18R* to *BIPRU 9.3.20R* (Disclosure requirements) and *BIPRU 9.15.11R* to *BIPRU 9.15.16R* (investor due diligence requirements) in any material respect by reason of its negligence or omission, the *FSA* will use its powers under section 45 (Variation etc. on the Authority's own initiative) of the *Act* to impose an additional capital charge of no less than 250% (capped at 1250%) of the *PRR* that would otherwise apply to the relevant *securitisation positions* under the *rules* in *BIPRU 7.2*. The additional capital charge imposed will be progressively increased with each relevant, subsequent infringement of the requirements in *BIPRU 9.3.18R* to *BIPRU 9.3.20R* and *BIPRU 9.15.11R* to *BIPRU 9.15.16R*. [deleted]~~
- 7.2.47C G ~~When calculating the additional capital charge it will impose under *BIPRU 7.2.47BG*, the *FSA* will take into account the exemption of certain *securitisations* from the scope of *BIPRU 9.15.3R* under *BIPRU 9.15.9R* and *BIPRU 9.15.10R* and, if those exemptions are relevant, reduce the capital charge it would otherwise impose. [deleted]~~
- 7.2.48 G ~~*BIPRU 7.2.43R* includes both actual and notional *positions*. However, notional *positions* in *zero specific risk security* do not attract *specific risk*. For example:~~
- (1) ~~interest rate *swaps*, *foreign currency swaps*, *FRAs*, interest rate *futures*, *foreign currency forwards*, *foreign currency futures*, and the cash leg of *repurchase agreements* and *reverse repurchase agreements* create notional *positions* which will not attract *specific risk*; whilst~~
- (2) ~~*futures, forwards and swaps* which are based on the price (or yield) of one or more debt *securities* will create at least one notional *position* that attracts *specific risk*. [deleted]~~

- 7.2.48A R (1) Subject to (3), a firm must calculate the specific risk portion of the interest rate PRR for each securitisation and resecuritisation position by multiplying the market value of the individual net position (ignoring the sign) by the appropriate PRA from the table in BIPRU 7.2.48DR or BIPRU 7.2.48ER, or in accordance with BIPRU 7.2.48FR, as applicable.
- (2) In calculating the specific risk capital charge of an individual net securitisation or resecuritisation position, a firm may cap the product of the weight and the individual net position at the maximum possible default-risk-related loss. For a short position, that limit may be calculated as a change in value due to the underlying names immediately becoming default-risk-free.
- (3) For a transitional period ending on 31 December 2013, where a firm holds securitisation and resecuritisation positions, other than positions included in the correlation trading portfolio, it must calculate:
- (a) the total specific risk capital charges that would apply just to the net long positions; and
- (b) the total specific risk capital charges that would apply just to the net short positions.

The total specific risk capital charge for securitisation and resecuritisation positions will be the higher of (3)(a) and (3)(b).

7.2.48B R The firm must report to the FSA the total sum of its weighted net long and net short securitisation and resecuritisation positions, broken down by types of underlying assets.

7.2.48C R When calculating the PRR of a protection seller in securitisation and resecuritisation credit derivatives, a firm must apply BIPRU 7.11.3R.

7.2.48D R Table: specific risk PRAs – standardised approach

<u>Credit quality step</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>4 (only for credit assessments other than short-term credit assessments)</u>	<u>All other credit quality steps</u>
<u>Securitisations</u>	<u>1.6%</u>	<u>4%</u>	<u>8%</u>	<u>28%</u>	<u>100%</u>
<u>Resecuritisations</u>	<u>3.2%</u>	<u>8%</u>	<u>18%</u>	<u>52%</u>	<u>100%</u>

A firm may only apply the PRAs in this table where it would have to calculate a risk weighted exposure amount in accordance with the standardised approach to securitisation and resecuritisation positions if such positions were in its non-trading book under BIPRU 9. The appropriate PRA is calculated as 8% of the risk weight that would apply to the position under the standardised approach in BIPRU 9.11.2R, subject to the requirements of BIPRU 9.9 to BIPRU 9.11, where appropriate.

7.2.48E R Table: specific risk PRAs – IRB approach

<u>Credit Quality Step</u>		<u>Securitisation positions</u>			<u>Resecuritisation positions</u>	
<u>Credit assessments other than short term</u>	<u>Short-term credit assessments</u>	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
<u>1</u>	<u>1</u>	<u>0.56%</u>	<u>0.96%</u>	<u>1.6%</u>	<u>1.6%</u>	<u>2.4%</u>
<u>2</u>		<u>0.64%</u>	<u>1.20%</u>	<u>2%</u>	<u>2%</u>	<u>3.2%</u>
<u>3</u>		<u>0.8%</u>	<u>1.44%</u>		<u>2.8%</u>	<u>4%</u>
<u>4</u>	<u>2</u>	<u>0.96%</u>	<u>1.6%</u>		<u>3.2%</u>	<u>5.2%</u>
<u>5</u>		<u>1.60%</u>	<u>2.8%</u>	<u>2.8%</u>	<u>4.8%</u>	<u>8%</u>
<u>6</u>		<u>2.8%</u>	<u>4%</u>		<u>8%</u>	<u>12%</u>
<u>7</u>	<u>3</u>	<u>4.8%</u>	<u>6%</u>		<u>12%</u>	<u>18%</u>
<u>8</u>		<u>8%</u>			<u>16%</u>	<u>28%</u>
<u>9</u>		<u>20%</u>			<u>24%</u>	<u>40%</u>
<u>10</u>		<u>34%</u>			<u>40%</u>	<u>52%</u>
<u>11</u>		<u>52%</u>			<u>60%</u>	<u>68%</u>
<u>all other unrated</u>		<u>100%</u>				

A firm may only apply the PRAs in this table where it would have to calculate a risk weighted exposure amount in accordance with the IRB approach to securitisation and resecuritisation positions if such positions were in its non-trading book under BIPRU 9. The appropriate PRA is calculated as 8% of the risk weight that would apply to the position under the IRB approach in BIPRU 9.12.11R, subject to the requirements in BIPRU 9.12 where appropriate.

7.2.48F R (1) A firm may use the supervisory formula method to calculate the

appropriate PRA for specific risk where:

- (a) the firm is permitted to apply the supervisory formula method to the same position if it was held in its non-trading book in accordance with BIPRU 9.12; or
- (b) otherwise, the firm is expressly permitted by its VaR model permission to apply the supervisory formula method to calculate the appropriate PRA for specific risk.
- (2) The appropriate PRA under the supervisory formula method must be calculated by multiplying the risk weight calculated according to BIPRU 9.12.21R by 8%.
- (3) Where relevant, estimates of PDs and LGDs as inputs to the supervisory formula method must be determined in accordance with BIPRU 4.
- (4) Where expressly permitted by its VaR model permission, a firm may use the approach outlined in BIPRU 7.10.55AR to BIPRU 7.10.55SR (Incremental Risk Charge) to determine PDs and LGDs as inputs to the supervisory formula method.
- 7.2.48G R Where a securitisation position in the trading book is subject to an increased risk weight in accordance with BIPRU 9.15, the appropriate PRA must be calculated as 8% of the risk weight that would apply to the position in accordance with BIPRU 9.15.
- 7.2.48H G Originators, investors and sponsors of securitisations in the trading book will have to meet the requirements of BIPRU 9.3.1AR, BIPRU 9.3.15R to BIPRU 9.3.20R and BIPRU 9.15.
- 7.2.48I G (1) Subject to BIPRU 7.2.48JG, BIPRU 9.15.9R and BIPRU 9.15.10R, where the investor, originator or sponsor of a securitisation fails to meet any of the requirements in BIPRU 9.3.18R to BIPRU 9.3.20R (Disclosure requirements) and BIPRU 9.15.11R to BIPRU 9.15.16R (investor due diligence requirements) in any material respect by reason of its negligence or omission, the FSA will use its powers under section 45 (Variation etc. on the Authority's own initiative) of the Act to impose an additional capital charge in accordance with BIPRU 7.2.48GR. The additional capital charge imposed will be progressively increased with each relevant, subsequent infringement of the requirements in BIPRU 9.3.18R to BIPRU 9.3.20R and BIPRU 9.15.11R to BIPRU 9.15.16AR, up to a maximum of 1250% risk weight.

(2) Subject to *BIPRU 9.3.22G*, *BIPRU 9.15.9R* and *BIPRU 9.15.10R*, where a *credit institution* fails to meet in any material respect the requirements in *BIPRU 9.15.16AR* (Group level requirements), the *FSA* may consider using its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* in the manner described in (1). In order to calculate the *risk weights* that would apply to the *credit institution*, the *FSA* may treat the *securitisation* investments of the *subsidiary undertaking* as if they were *securitisation positions* held directly by the *credit institution*.

7.2.48J G When calculating the additional capital charge it will impose under *BIPRU 7.2.48GR*, the *FSA* will take into account the exemption of certain *securitisations* from the scope of *BIPRU 9.15.3R* under *BIPRU 9.15.9R* and *BIPRU 9.15.10R* and, if those exemptions are relevant, it will reduce the capital charge it would otherwise impose.

7.2.48K R A *securitisation exposure* in the *trading book* that would be subject to deduction in accordance with *GENPRU 2.2*. (Capital resources) or to a *1250% risk weight* in accordance with *BIPRU 9* (Securitisation) is subject to a capital charge that is no less than that set out under those provisions, capped at the maximum possible default-risk-related loss. Unrated liquidity facilities are subject to a capital charge that is no less than that set out in *BIPRU 9*.

Specific risk: correlation trading portfolio

7.2.48L R (1) Where a *firm* holds a *position* in the *correlation trading portfolio*, it must calculate:

(a) The total *specific risk* capital charges that would apply just to the net long *positions* of the *correlation trading portfolio*; and

(b) The total *specific risk* capital charges that would apply just to the net short *positions* of the *correlation trading portfolio*.

(2) The higher of (1)(a) and (1)(b) will be the *specific risk* capital charge for the *correlation trading portfolio*.

(3) In calculating the *specific risk* capital charge of an individual net *position* in the *correlation trading portfolio*, a *firm* may cap the product of multiplying the individual net *position* by the *appropriate PRA* at the maximum possible default-risk-related loss. For a short *position*, a *firm* may calculate the maximum possible default-risk-related loss as a change in value due to the underlying names immediately becoming default-risk-free.

...

7.3.30 R Table: simplified equity method PRAs

This table belongs to *BIPRU 7.3.29R*

Instrument	<i>PRA</i>
Single <i>equities</i>	12% <u>16%</u>
<i>Qualifying equity indices</i> indices (see <i>BIPRU 7.3.38R</i>)	8%
All other <i>equity</i> indices or baskets	12% <u>16%</u>
If it is necessary to distinguish between the <i>specific risk PRA</i> and the <i>general market risk PRA</i> , the <i>specific risk PRA</i> for the first and third rows is 4 <u>8</u> % and that for the second row is 0%. The rest of the <i>PRA</i> in the second column is the <i>general market risk PRA</i> .	

...

7.3.34 R Table: PRAs for specific risk under the standard equity method

This table belongs to *BIPRU 7.3.33R*

Instrument	<i>PRA</i>
<i>Qualifying equities</i>	2%
<i>Qualifying equity indices</i> indices (see <i>BIPRU 7.3.38R</i>)	0%
All other <i>equities</i> , <u>and other</u> <i>equity</i> indices or equities <u>equity</u> baskets.	4% <u>8%</u>

Definition of a qualifying equity

7.3.35 R *A qualifying equity* is one that satisfies the following conditions:

- (1) ~~it belongs to a country portfolio that satisfies the following conditions:~~
 - (a) ~~no individual position exceeds 10% of the portfolio's gross value; and~~
 - (b) ~~the sum of positions (ignoring the sign) which individually represent between 5% and 10% of the portfolio's gross value, does not exceed 50% of the portfolio's gross value;~~
- (2) ~~it is not of an issuer that has issued only traded debt securities that currently attracts an 8% or 12% PRA in the table in BIPRU 7.2.44R (Specific risk PRA) or that attracts a lower requirement only because they are guaranteed or secured; and~~

- (3) ~~it is a constituent of an index in the table in *BIPRU 7.3.39R*.
[deleted]~~
- 7.3.36 G (1) ~~The following example illustrates *BIPRU 7.3.35R(1)*.~~
- (2) ~~A country portfolio has a gross value of £100 and is made up of *positions* in 29 different *equities* (some are long *positions*, others are short *positions*). Not all the *equities* are constituents of an index used to create the FT All-World Index (this criterion only becomes relevant once a *firm* has determined whether the country portfolio meets the test in *BIPRU 7.3.35R(1)*).~~
- (3) ~~Six *positions* exceed the 5% threshold. The following diagram shows the composition of the portfolio.
[Diagram deleted]~~
- (4) ~~Part (a): the portfolio meets the first part of the test because no individual *position* is worth more than 10% of the portfolio's value.~~
- (5) ~~Part (b): the portfolio fails the second part of the test because the sum (ignoring the sign) of the six relevant *positions* is £52; this exceeds 50% of the portfolio's value. [deleted]~~
- 7.3.37 G (1) ~~A country portfolio can be split into two sub-portfolios if this enables one sub-portfolio to meet the requirements in *BIPRU 7.3.35R(1)*. Individual *positions* may be sub-divided between sub-portfolios.~~
- (2) ~~Continuing the example above, one of the largest *positions* is taken out of the portfolio and put into a new portfolio. The new portfolio fails the two tests, but the amended portfolio meets both tests:~~
- (a) ~~Part (a): no single remaining *position* exceeds £9.10.~~
- (b) ~~Part (b): the sum of the five relevant *positions* is £43, this is less than 50% of the new portfolio's value of £91. [deleted]
[Diagram deleted]~~
- ...
- 7.10.27A R *Stressed VaR* must be calculated at least weekly, using a 99% one-tailed confidence limit.
- ...
- 7.10.30A R The *stressed VaR* measure must be based on inputs calibrated to historical data from a continuous twelve-month period of significant financial stress

relevant to the firm's portfolio. The choice of that historical period will be subject to the FSA's approval and will form part of a firm's VaR model permission.

- 7.10.30B R A firm must review the selection of the stressed VaR historical observation period at least annually.
- ...
- 7.10.35 G The minimum updating frequency for the current VaR measure that can be specified in a *VaR model permission* is ~~quarterly~~ monthly.
- ...
- 7.10.39A R A firm must incorporate risk factors that are included in its pricing model in its VaR model. A firm's VaR model must capture nonlinearities for options and other products, as well as correlation risk and basis risk. Where proxies for risk factors are used they must show a good track record for the actual position held. In addition, BIPRU 7.10.40R to BIPRU 7.10.44R apply for individual risk types.
- 7.10.39B R A firm with a VaR model permission must justify to the FSA any omissions of risk factors from its VaR model, if they are included in its pricing model.
- ...
- 7.10.46 R ...
- (7) In addition to the other requirements in *BIPRU 7.10*, a firm must have an approach in place to capture, in the calculation of its capital requirements, the ~~default risk~~ incremental risk charge of its *trading book positions* that is incremental to the default and migration risk captured by the *VaR measures*, as specified in ~~this rule, BIPRU 7.10.48R, BIPRU 7.10.49R~~ BIPRU 7.10.55AR to BIPRU 7.10.55SR and *BIPRU 7.10.107R* (Backtesting: Specific risk backtesting).
- (8) ~~A firm must be able to demonstrate that the approach referred to in (7) meets soundness standards comparable to the approach set out in BIPRU 4 (The IRB approach), under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality.~~
[deleted]
- ...
- 7.10.48 R (1) ~~Where a firm is subject to event risk that is not reached in its VaR measure, because it is beyond the 10-day holding period and 99 percent confidence interval (low probability and high severity events), the firm must ensure that the impact of such~~

events is factored into its internal capital assessment. [deleted]

(2) ...

...

7.10.50 R ~~To avoid double counting capital requirements under BIPRU 7.10.46R(7) a firm may, when calculating its incremental default charge, take into account the extent to which default risk has already been incorporated into the VaR calculation, especially for risk positions that could and would be closed within 10 business days in the event of adverse market conditions or other indications of deterioration in the credit environment. Where a firm captures its incremental default risk through a surcharge, it must have in place methodologies for validating the measure. [deleted]~~

7.10.51 R ~~A firm that does not capture the incremental default risk through an internally developed approach must calculate the surcharge through an approach consistent with either the standardised approach to credit risk or the IRB approach. [deleted]~~

7.10.52 R ~~With respect to securitisation exposures that would be subject to a deduction treatment in the calculation of its capital resources or risk weighted at 1250% as set out in BIPRU 9, these positions (cash or synthetic) are subject to a capital charge that is no less than set forth under that treatment. A firm that is a dealer in these exposures may apply a different treatment where it could demonstrate to the FSA, in addition to trading intent, that a liquid two-way market exists for the securitisation exposures or, in the case of synthetic securitisation that rely solely on credit derivatives, for the securitisation exposures themselves or all their constituent risk components. For the purposes of this rule a two-way market is deemed to exist where there are independent good faith offers to buy and sell so that a price reasonably related to the last sales price or current good faith competitive bid and offer quotations can be determined within one day and settled at such a price within a relatively short time conforming to trade custom. For a firm to apply a different treatment, it must have sufficient market data to ensure that it fully captures the concentrated default risk of these exposures in its internal approach for measuring the incremental default risk in accordance with the VaR specific risk minimum requirements. [deleted]~~

...

Incremental risk charge: Scope and parameters

7.10.55A R A firm must demonstrate that its incremental risk charge meets soundness standards comparable to those under the IRB approach, assuming a constant level of risk and adjusted, where appropriate, to reflect the impact of liquidity, concentrations, hedging and optionality.

7.10.55B R The incremental risk charge must cover all positions which are subject to a capital charge for interest-rate specific risk in accordance with the

firm's VaR model permission, except securitisation positions and nth-to-default credit derivatives. Where permitted by its VaR model permission, a firm may choose consistently to include all listed equity positions and derivatives positions based on listed equities for which that inclusion is consistent with how the firm internally measures and manages risk, but the approach must reflect the impact of correlations between default and migration events, and it must not reflect the impact of diversification between default and migration events and other market risk factors.

- 7.10.55C R The firm's approach to capture the incremental risk charge must measure losses due to default and internal or external ratings migration at the 99.9% confidence interval over a capital horizon of one year.
- 7.10.55D R The firm's correlation assumptions must be supported by the analysis of objective data in a conceptually sound framework. The approach to capture the incremental risk charge must appropriately reflect issuer concentrations. Concentrations that can arise within and across product classes under stressed conditions must also be reflected.
- 7.10.55E R The firm's approach must be based on the assumption of a constant level of risk over the one-year capital horizon, implying that given individual trading book positions or sets of positions that have experienced default or migration over their liquidity horizon are re-balanced at the end of their liquidity horizon to attain the initial level of risk. Alternatively, a firm may choose consistently to use a one-year constant position assumption.

Incremental risk charge: Liquidity horizons

- 7.10.55F R (1) The firm's liquidity horizons for calculating incremental risk charge must be set according to the time required to sell the position or to hedge all material and relevant price risks in a stressed market, having particular regard to the size of the position.
- (2) Liquidity horizons must reflect actual practice and experience during periods of both systematic and idiosyncratic stresses. The liquidity horizon must be measured under conservative assumptions and must be sufficiently long that the act of selling or hedging, in itself, would not materially affect the price at which the selling or hedging would be executed.
- 7.10.55G R The determination of the appropriate liquidity horizon for a position or set of positions is subject to a floor of three months. The determination of the appropriate liquidity horizon for a position or set of positions must take into account a firm's internal policies relating to valuation adjustments and the management of stale positions.
- 7.10.55H R When a firm determines liquidity horizons for sets of positions rather than for individual positions, the criteria for defining sets of positions must be defined in a way that meaningfully reflects differences in liquidity. The

liquidity horizons must be greater for *positions* that are concentrated, reflecting the longer period needed to liquidate those *positions*.

- 7.10.55I R The liquidity horizon for a *securitisation* warehouse must reflect the time to build, sell and securitise the assets, or to hedge the material risk factors, under stressed market conditions.

Incremental risk charge: Hedges

- 7.10.55J R (1) Hedges may be incorporated into the calculation of a *firm's incremental risk charge*. *Positions* may be netted only when long and short *positions* refer to the same financial instrument.
- (2) Hedging or diversification effects associated with long and short *positions* involving different instruments or different securities of the same obligor, as well as long and short *positions* in different *issuers*, may only be recognised by explicitly modelling gross long and short *positions* in the different instruments.
- (3) A *firm* must reflect the impact of material risks that could occur during the interval between the hedge's maturity and the liquidity horizon, as well as the potential for significant basis risks in hedging strategies by product, seniority in the capital structure, internal or external rating, maturity, vintage and other differences in the instruments. A *firm* must reflect a hedge only to the extent that it can be maintained even as the obligor approaches a credit or other event.
- 7.10.55K R For *trading book positions* that are hedged via dynamic hedging strategies, a rebalancing of the hedge within the liquidity horizon of the hedged position may be recognised only if the *firm*:

- (1) chooses to model rebalancing of the hedge consistently over the relevant set of *trading book positions*;
- (2) demonstrates that the inclusion of rebalancing results in a better risk measurement;
- (3) demonstrates that the markets for the instruments serving as hedges are liquid enough to allow for this rebalancing even during periods of stress; and
- (4) reflects in the capital charge any residual risks resulting from dynamic hedging strategies.

Incremental risk charge: Nonlinear positions and model risk

- 7.10.55L R (1) The *incremental risk charge* must reflect the nonlinear impact of *options*, structured credit derivatives and other *positions* with material nonlinear behaviour with respect to price changes.

- (2) The *firm* must also consider the amount of model risk inherent in the valuation and estimation of price risks associated with those products.

7.10.55M R The *incremental risk charge* must be based on objective and up-to-date data.

Incremental risk charge: Validation

7.10.55N R A *firm* must validate its approach to *incremental risk charge*. In particular, a *firm* must:

- (1) validate that its modelling approach for correlations and price changes is appropriate for its portfolio, including the choice and weights of its systematic risk factors;
- (2) perform a variety of stress tests (not limited to the range of events experienced historically), including sensitivity analysis and scenario analysis, to assess the qualitative and quantitative reasonableness of the approach, with particular regard to the treatment of concentrations; and
- (3) apply appropriate quantitative validation including relevant internal modelling benchmarks.

7.10.55O R A *firm's* approach for *incremental risk charge* must be consistent with the *firm's* internal risk management methodologies for identifying, measuring, and managing trading risks.

Incremental risk charge: Documentation and frequency of calculation

7.10.55P R A *firm* must document its approach for the *incremental risk charge* clearly, setting out its correlation and other modelling assumptions.

7.10.55Q R A *firm* must calculate its *incremental risk charge* at least weekly.

Incremental risk charge: Internal approaches based on different parameters

7.10.55R R A *firm* may use an approach for *incremental risk charge* that does not comply with all the requirements in *BIPRU* 7.10.55AR to *BIPRU* 7.10.55PR, only if:

- (1) such an approach is consistent with the *firm's* internal methodologies for identifying, measuring, and managing risks; and
- (2) the *firm* can demonstrate that its approach results in a capital requirement that is at least as high as it would be if based on an approach in full compliance with the requirements in *BIPRU* 7.10.55AR to *BIPRU* 7.10.55PR.

7.10.55S G The FSA will review at least annually any approach taken by the firm under BIPRU 7.10.55RR.

All price risk measure: General requirements

7.10.55T R As part of its VaR model permission, the FSA may authorise a firm to use the all price risk measure to calculate an additional capital charge in relation to positions in its correlation trading portfolio if it meets the following minimum standards:

- (1) it adequately captures all price risks at a 99.9% confidence interval over a capital horizon of one year under the assumption of a constant level of risk, and adjusted, where appropriate, to reflect the impact of liquidity, concentrations, hedging and optionality;
- (2) it adequately captures the following risks:
 - (a) the cumulative risk arising from multiple defaults, including the ordering of defaults, in tranchéd products;
 - (b) credit spread risk, including the gamma and cross-gamma effects;
 - (c) volatility of implied correlations, including the cross effect between spreads and correlations;
 - (d) basis risk, including both:
 - (i) the basis between the spread of an index and those of its constituent single names; and
 - (ii) the basis between the implied correlation of an index and that of bespoke portfolios;
 - (e) recovery-rate volatility, as it relates to the propensity for recovery rates to affect tranche prices; and
 - (f) to the extent that the all price risk measure incorporates benefits from dynamic hedging, the risk of hedge slippage and the potential costs of rebalancing those hedges.

7.10.55U R The amount of the capital charge for the correlation trading portfolio calculated in accordance with the all price risk measure must not be less than 8% of the capital charge that would result from applying BIPRU 7.2.48LR to all positions in the correlation trading portfolio subject to the all price risk measure.

7.10.55V R A firm may include in its all price risk measure positions that are jointly

managed with *positions* in the *correlation trading portfolio* and would otherwise be included in the *incremental risk charge*. In that case, the *firm* must exclude these *positions* from the calculation of its *incremental risk charge*.

7.10.55W R A *firm* must have sufficient market data to ensure that it fully captures the salient risks of the *positions* in its *all price risk measure* in accordance with the standards set out in *BIPRU 7.10.55TR*.

7.10.55X R A *firm* must demonstrate through backtesting or other appropriate means that its *all price risk measure* can appropriately explain the historical price variation of these *positions*. A *firm* must be able to demonstrate to the *FSA* that it can identify the *positions* within its *correlation trading portfolio*, in relation to which it is authorised to use the *all price risk measure*, separately from those other *positions* in relation to which it is not authorised to do so.

7.10.55Y R A *firm* must calculate the capital charge under the *all price risk measure* at least weekly.

All price risk measure: Stress testing

7.10.55Z R (1) For *positions* within its *correlation trading portfolio* in relation to which a *firm* may use the *all price risk measure*, a *firm* must regularly apply a set of specific, predetermined stress scenarios. These stress scenarios must examine the effects of stress to default rates, recovery rates, credit spreads, and correlations on the profit and loss of the *correlation trading portfolio*.

(2) A *firm* must apply the stress scenarios in (1) at least weekly and report the results to the *FSA* in accordance with *BIPRU 7.10.129R*.

7.10.55Z R If the results of the stress tests carried out in accordance with *BIPRU A* 7.10.55ZR indicate a material shortfall in the amount of capital required under the *all price risk measure*, a *firm* must notify the *FSA* of this circumstance by no later than two *business days* after the *business day* on which the material shortfall occurred.

7.10.55Z G The *FSA* may use its powers under section 45 (Variation etc. on the B Authority's own initiative) of the *Act* to impose on the *firm* a capital add-on to cover the material shortfall reported under *BIPRU 7.10.55ZAR*.

7.10.55Z G The *all price risk measure* is based on the *incremental risk charge*. C Therefore, when applying the *all price risk measure*, a *firm* should have regard to the requirements in *BIPRU 7.10.55AR* to *BIPRU 7.10.55RR*.

...

7.10.90A R A *firm* must also carry out reverse stress tests.

...

- 7.10.93 G Backtesting conducted only at a whole portfolio level using a single measure of profit and loss has limited power to distinguish an accurate *VaR model* from an inaccurate one. Backtesting should therefore be regarded as an additional safeguard rather than a primary validation tool. Such testing does however form the basis of the *FSA's plus factor* system. The test has been chosen as the basis of the backtesting regime because of its simplicity. A *firm* will therefore be expected to complement this backtesting with more granular backtesting analysis and involving more than one measure of profit and loss (i.e. both a ~~*clean*~~ *profit and loss figure* and a ~~*clean*~~ *hypothetical profit and loss figure*).
- 7.10.94 R A *firm* must have the capacity to analyse and compare its ~~*clean*~~ *profit and loss figures* and ~~*clean*~~ *hypothetical profit and loss figures* to the *VaR measure*, both at the level of the whole portfolio covered by the *VaR model permission* and at the level of individual books that contain material amounts of risk.
- 7.10.94A R At a minimum, backtesting of hypothetical profit and loss figures must be used for regulatory backtesting and also to calculate plus factors.
- 7.10.95 G ~~Clean profit and loss backtesting should be used for regulatory backtesting and used to calculate plus factors.~~ Hypothetical profit and loss backtesting Backtesting of hypothetical profit and loss figures is also used for model validation and for reporting to the *FSA*.

Backtesting: Basic testing requirements

- 7.10.96 R ~~A~~ At a minimum, a firm must, on each *business day*, compare each of its 250 most recent *business days'* ~~*clean profit and loss figures*~~ *hypothetical profit and loss figures* (ending with the *business day* preceding the *business day* in question) with the corresponding one-day *VaR measures*.

...

Backtesting: Calculating the ~~*clean*~~ profit and loss

- 7.10.99 G The ultimate purpose of backtesting is to assess whether capital is sufficient to absorb actual losses. ~~Therefore backtesting should be performed using a measure of actual daily profit and loss.~~ Actual daily profit and loss means the day's profit and loss arising from trading activities within the scope of the *VaR model permission*. This measure should, however, be 'cleaned' using *BIPRU 7.10.100R* inclusion in profit and loss of non-modelled factors.
- 7.10.100 R The ~~*clean*~~ *profit and loss figure* for a particular *business day* is the *firm's* actual profit or loss for that day in respect of the trading activities within the scope of the *firm's VaR model permission*, adjusted by stripping out:
- (1) fees and commissions;

- (2) brokerage;
 - (3) additions to and releases from reserves which are not directly related to *market risk* (e.g. administration reserves); and
 - (4) any inception profit exceeding an amount specified for this purpose in the *firm's VaR model permission* (where inception profit is defined as any profit arising immediately on entering into a new transaction).
- 7.10.101 G The definition of ~~*clean profit and loss figure*~~ may be amended or replaced in an individual *VaR model permission* if the *firm* can demonstrate to the FSA that the alternative method meets the spirit and purpose of the provisions in BIPRU 7.10 about the ~~*clean profit and loss figure*~~.
- 7.10.102 G The FSA will review as part of a *firm's VaR model permission* application the processes and documentation relating to the derivation of profit and loss used for backtesting. A *firm's* documentation should clearly set out the basis for cleaning profit and loss. To the extent that certain profit and loss elements are not updated every day (for example certain reserve calculations) the documentation should clearly set out how such elements are included in the ~~*clean*~~ profit and loss series.

Backtesting: Definition of backtesting exception

- 7.10.103 R A *backtesting exception* is deemed to have occurred for any *business day* if the ~~*clean profit and loss figure*~~ *hypothetical profit and loss figure* for that *business day* shows a loss, which in absolute magnitude exceeds the *one-day VaR measure* for that *business day*. The only exception is if that *business day* is identified in the *firm's VaR model permission* as giving rise to an excluded *backtesting exception*.

...

Backtesting: Hypothetical profit and loss

- 7.10.111 R A *firm* must ~~also~~ perform backtesting against a ~~*clean*~~ *hypothetical profit and loss figure* with respect to each *business day*. A ~~*clean*~~ *hypothetical profit and loss figure* for a *business day* means the ~~*clean profit and loss figure*~~ *hypothetical profit and loss figure* that would have occurred for that *business day* if the portfolio on which the *VaR number* for that *business day* is based remained unchanged.
- 7.10.112 G
- (1) ~~A *clean*~~ *hypothetical profit and loss figure* *hypothetical profit and loss figure* is based on the day's change in the value of the same portfolio that was used to generate the value-at-risk forecast.
 - (2) ~~Backtesting under BIPRU 7.10.111R, although carried out with respect to each *business day*, need not be carried out each day. A *firm* need only carry it out sufficiently frequently to comply~~

with its reporting requirements under *BIPRU 7.10.129R*. An exception arising out of such backtesting need not be reported to the *FSA* under *BIPRU 7.10.104R*. [deleted]

- (3) The *firm* may also need to calculate a ~~*clean hypothetical profit and loss figure*~~ *hypothetical profit and loss figure* in order to produce profit attribution reports and to analyse the cause of *backtesting exceptions*.

7.10.112 A G The definition of *hypothetical profit and loss figure* may be amended or replaced in an individual *VaR model permission* if the *firm* can demonstrate to the *FSA* that the alternative method meets the spirit and purpose of the provisions in *BIPRU 7.10* about the *hypothetical profit and loss figure*.

Capital calculations: General

- 7.10.113 R The *model PRR* is, for any *business day* (the “relevant” *business day*), calculated in accordance with the following formula:
- (1) ...
- (2) (in the case of a *VaR model permission* that covers *specific risk*) the ~~*incremental default risk charge*~~ for the relevant *business day* higher of:
- (a) the *incremental risk charge* for the relevant *business day*; and
- (b) the average of the twelve-week *incremental risk charge*; and
- (3) the higher of:
- (a) the latest *stressed VaR number*; and
- (b) the average of the *firm’s* daily *stressed VaR numbers* for the 60 *business days* ending with the relevant *business day*, multiplied by the *multiplication factor* applied to the *stressed VaR* measure for the relevant *business day*; and
- (4) (in the case of a *VaR model permission* that covers *all price risk measure*) the higher of:
- (a) the *all price risk measure* for the relevant *business day*; and
- (b) the average of the twelve-week *all price risk measure*.

...

7.10.116 R The ~~incremental default risk charge~~ incremental risk charge for any *business day* means the ~~incremental default risk charge~~ incremental risk charge required under the provisions in *BIPRU* 7.10 about *specific risk*, in respect of the previous *business day*'s close-of-business *positions* with respect to which those provisions apply.

7.10.116 R
A The all price risk measure for any *business day* means the all price risk measure required under the provisions in *BIPRU* 7.10 about *specific risk* for the correlation trading portfolio.

7.10.117 G The following equation expresses *BIPRU* 7.10.113R mathematically:
[Editor's Note: The existing formula is deleted and is replaced by the following, which is not shown underlined.]

$$PRR_{VaR} = \text{Max} \left\{ VaR_t, f \times \frac{1}{60} \sum_{i=0}^{59} VaR_{t-i} \right\} + \text{Max} \left\{ SVaR_t, s \times \frac{1}{y} \sum_{i=0}^{y-1} SVaR_{t-i} \right\} + \text{Max} \left\{ IRC_t, \frac{1}{z} \sum_{i=0}^{z-1} IRC_{t-i} \right\} + \text{Max} \left\{ APR_t, \frac{1}{w} \sum_{i=0}^{w-1} APR_{t-i} \right\}$$

...

- (4) f is the multiplication factor for VaR; ~~and~~
- (5) ~~IDRC is the incremental default risk charge (if applicable)~~
SVAR_t represents the latest stressed VaR figure;
- (6) SVAR_{t-i} represents the stressed VaR calculated for i business days earlier;
- (7) s is the multiplication factor for stressed VaR;
- (8) y is the number of times the stressed VaR was calculated in the last 60 business days;
- (9) IRC_t represents the latest incremental risk charge;
- (10) IRC_{t-i} represents the incremental risk charge calculated for i business days earlier;
- (11) z is the number of times the incremental risk charge was calculated in the last 12 weeks;
- (12) APR_t represents the latest all price risk measure;
- (13) APR_{t-i} represents the all price risk measure calculated for i business days earlier; ~~and~~
- (14) w is the number of times the all price risk measure was calculated in the last 12 weeks.

Capital calculations: Multiplication factors

7.10.118 R The multiplication factor, for VaR and stressed VaR, for any *business day* is the sum of the minimum multiplication factor and the plus factor

for that day.

7.10.119 R The *minimum multiplication factor, for VaR and stressed VaR*, is three or any higher amount the *VaR model permission* defines it as.

7.10.120 G The *minimum multiplication factor, for VaR and stressed VaR*, will never be less than three. If the *FSA* does set the *minimum multiplication factor, for VaR and stressed VaR*, above three the *VaR model permission* will have a table that sets ~~outs~~ out the reasons for that add on and specify how much of the add on is attributable to each reason (see *BIPRU 7.10.121R*). If there are weaknesses in the *VaR model* that may otherwise be considered a breach of the minimum standards referred to in *BIPRU 7.10.42R* the *FSA* may apply such an add on to act as a mitigant for those weaknesses.

7.10.121 R Something that would otherwise be a breach of the minimum standards ~~to~~ in *BIPRU 7.10.26R – BIPRU 7.10.53R* is not a breach to the extent that that thing is identified in the *firm's VaR permission* as a reason for an increase in the *minimum multiplication factor, for VaR and stressed VaR*, above 3.

...

7.10.124 R The table in *BIPRU 7.10.125R* sets out the *plus factors* to be added to the *minimum multiplication factor, for VaR and stressed VaR*, for any *business day*. It is based on the number of *backtesting exceptions* that occurred during the backtesting period as referred to in *BIPRU 7.10.96R* (Backtesting: Basic Backtesting requirements) ending three *business days* preceding the *business day* for which the *model PRR* is being calculated.

...

7.10.129 R A *firm* must, no later than the number of *business days* after the end of each quarter specified in the *VaR model permission* for this purpose, submit, in respect of that quarter, a report to the *FSA* about the operation of the *VaR model*, the systems and controls relating to it and any changes to the *VaR model* and those systems and controls. Each report must outline as a minimum the following information in respect of that quarter:

...

(3) a summary of backtesting performance against ~~clean~~ *profit and loss figures (if calculated)* and ~~clean~~ *hypothetical profit and loss figures*, which must be provided in electronic format as stipulated by the *VaR model permission*;

...

(9) an up-to-date list of products covered by the *VaR model permission* showing all changes made since the *VaR model*

permission was granted; ~~and~~

(10) where applicable (nil returns are not required), details of:

...

(f) the *VaR model* not accurately capturing risks (as referred to in *BIPRU 7.10.53R*) and any steps taken under *BIPRU 7.10.53R*; and

(11) the results of the stress tests on the firm's correlation trading portfolio under *BIPRU 7.10.55ZR*, including a comparison to the current capital charge.

7.10.130 R A *firm* must provide to, and discuss with, the *FSA* details of any significant planned changes to the *VaR model* before those changes are implemented. These details must include information about the nature of the change and an estimate of the impact on *VaR numbers* and the *incremental default risk charge*.

...

7.10.136 R (1) ...

(2) ~~If~~ Subject to *BIPRU 7.10.136AR*, if, where the *standard market risk PRR rules* apply, a *position* is subject to a *PRR charge* and the *firm's VaR model permission* says that it covers the risks to which that *PRR charge* relates, the *firm* must, for those risks, calculate the *PRR* for that *position* under the *VaR model approach* rather than under the *standard market risk PRR rules*.

...

7.10.136 R A *firm* must calculate the market risk capital requirement for securitisation positions and positions in the correlation trading portfolio in accordance with the standard market risk PRR rules, with the exception of those positions subject to the all price risk measure.

A

...

7.11.3 R (1) When calculating the *PRR* of the *protection seller*, unless specified differently by other *rules* and subject to (2), the notional amount of the credit derivative contract must be used. For the purpose of calculating the *specific risk PRR charge*, other than for total return swaps, the maturity of the credit derivative contract is applicable instead of the maturity of the obligation.

(2) When calculating the *PRR* of the *protection seller*, a *firm* may choose to replace the notional value of the credit derivative by the notional value adjusted for changes in the market value of

the credit derivative since trade inception.

...

- 7.11.11 R If ~~a first or second asset to default~~ an nth-to-default derivative is externally rated and meets the conditions for a *qualifying debt security*, then the *protection seller* need only calculate one *specific risk* charge reflecting the rating of the derivative. The *specific risk* charge must be based on the *securitisation PRAs* in *BIPRU 7.2* as applicable.

...

Deriving the net position in each debt security: Credit derivatives

- 7.11.12C R A firm must calculate both the net long and the net short positions in credit derivatives by applying *BIPRU 7.2.36R* and *BIPRU 7.2.37R* and, where applicable, *BIPRU 7.2.42AR* to *BIPRU 7.2.42CR* or *BIPRU 7.11.13R* to *BIPRU 7.11.17R*.

Recognition of hedging provided by credit derivatives ~~against cash positions~~

- 7.11.13 R (1) ...
- (2) ...
- (3) ~~*BIPRU 7.11.13 R*—*BIPRU 7.11.17 R* are subject to the requirements of the *credit default swap PRR methods*. [deleted]~~

...

Special treatment of credit default swaps: Provisions applicable to all methods
Specific risk calculation

...

- 7.11.18 R ~~*BIPRU 7.11.18R*—*BIPRU 7.11.58R* set out the calculation of the *specific risk* portion of the *interest rate PRR* for credit default swaps. [deleted]~~

- 7.11.19 R ~~The *specific risk* portion of the *interest rate PRR* is calculated separately for:~~
- (1) ~~credit default swaps (other than those in (2));~~
- (2) ~~credit default swaps that are also *securitisation positions*;~~
- (3) ~~other *positions*;~~
- ~~that are subject to the *interest rate PRR*. [deleted]~~

- 7.11.20 R The *specific risk* portion of the *interest rate PRR* for ~~positions falling into~~ *BIPRU 7.11.19R(1)* and *BIPRU 7.11.19R(2)* credit derivatives in the trading book must be calculated in accordance with ~~the *credit default swap PRR methods* rather than in accordance with *BIPRU 7.2* (Interest~~

~~rate PRR) BIPRU 7.2.43R to BIPRU 7.2.46AG (Specific risk calculation), BIPRU 7.2.48AR to BIPRU 7.2.48KR (Specific risk: securitisations and re-securitisations), BIPRU 7.2.48LR (Specific risk: Correlation trading portfolio), BIPRU 7.2.49R to BIPRU 7.2.51G (Definition of a qualifying debt security) and the other provisions of BIPRU 7.11, as applicable. However a *firm* may apply BIPRU 7.11.13R- BIPRU 7.11.17R before applying the *credit default swap PRR methods*. If it does so the *firm* must apply the *credit default swap PRR methods* to the remaining position in credit default swaps.~~

Delete 7.11.21R to 7.11.58R. The deleted text is not shown.

Amend the following as shown.

7.11.61 G ~~BIPRU 7.11.62G - BIPRU 7.11.64G~~ 7.11.63G cover risks relating to credit derivatives that may not be captured in this section. This *guidance* is of particular relevance to the *overall financial adequacy rule*, the *overall Pillar 2 rule* and the *general stress and scenario testing rule*.

...

7.11.64 G ~~If a *firm* uses models in its valuation process, it should consider whether the default capital requirements under the *credit default swap PRR methods* adequately cover the default losses that the *firm's* model estimates it will be exposed to: [deleted]~~

...

9.1.9 G *BIPRU 9* deals with:

...

(3) the requirements that investors, *originators* and *sponsors* of *securitisations* in the *trading book* will have to meet (*BIPRU 9.3.1AR*, *BIPRU 9.3.15R* to *BIPRU 9.3.20R*, *BIPRU 9.6.1AR* and *BIPRU 9.15*).

...

9.3.2 G ~~[deleted]~~ A *credit institution* should have regard to the Committee of European Banking Supervisors' Guidelines to Article 122a of the *Banking Consolidation Directive* when considering its obligations under *BIPRU 9.3.15R* to *BIPRU 9.3.20R* and *BIPRU 9.15*. The Guidelines can be found at <http://www.eba.europa.eu/Publications/Standards-Guidelines.aspx>.

...

Origination criteria

- 9.3.15 R A *credit institution*, whether acting as *sponsor* or *originator*, must apply the same sound and well-defined criteria used for credit-granting in respect of exposures held on their *trading* and *non-trading book* under SYSC 7.1.9R to exposures to be securitised. The criteria applied must include the processes for approving and, where relevant, amending, renewing and re-financing credits.
- ...
- ...
- 9.6.1 R An *originator* which, in respect of a securitisation in the *non-trading book*, has made use of BIPRU 9.3.1R in the calculation of *risk weighted exposure amounts*, or a *sponsor*, must not, with a view to reducing potential or actual losses to investors, provide support to the *securitisation* beyond its contractual obligations.
- [Note: BCD Article 101(1)]
- 9.6.1A R An *originator* which has sold instruments in its *trading book* to an *SSPE* and no longer holds *market risk capital requirements* for these instruments, or a *sponsor*, must not, with a view to reducing potential or actual losses to investors, provide support to the *securitisation* beyond its contractual obligations.
- [Note: BCD Article 101(1)]
- 9.6.2 R If an *originator* or *sponsor* fails to comply with BIPRU 9.6.1R or BIPRU 9.6.1AR in respect of a *securitisation*, it must:
- (1) hold capital against all of the *securitised exposures* associated with the *securitisation* transaction as if they had not been *securitised*; and
 - (2) disclose publicly:
 - (a) that it has provided non-contractual support; and
 - (b) the regulatory capital impact of doing so.
- ...
- ...
- 9.7.2 R (1) A *firm* ~~may~~ must not use the credit assessment of an *eligible ECAI* to determine the *risk weight* of a *securitisation position* in accordance with BIPRU 9.9 unless it complies with the principles of credibility and transparency as elaborated in (2) to (46).

...

- (5) The credit assessment must not be based, or partly based, on unfunded support provided by the *firm* itself.
- (6) In the case of a credit assessment referred to in (5), the *firm* must consider the relevant position as if it were not rated and must apply the relevant treatment of unrated positions as set out in *BIPRU* 9.11 and *BIPRU* 9.12.

[**Note:** *BCD*, Article 97(5) and Annex IX, Part 3, Point 1]

- 9.7.2A G The requirements in *BIPRU* 9.7.2R(5) and (6) apply to situations where a *firm* holds *securitisation positions* which receive a lower *risk weight* by virtue of unfunded credit protection provided by the *firm* itself acting in a different capacity in the *securitisation* transaction. The assessment of whether a *firm* is providing unfunded support to its *securitisation positions* should take into account the economic substance of that support in the context of the overall transaction and any circumstances in which the *firm* could become exposed to a higher credit risk in the absence of that support.

...

- 9.7.4 G Where *BIPRU* 9.7.2R(5) applies to *securitisation positions* in an *ABCP programme*, the *firm* may be granted a *waiver* which allows it to use the *risk weight* assigned to a *liquidity facility* in order to calculate the *risk weighted exposure amount* for the positions in the *ABCP programme*, provided that the *liquidity facility* ranks *pari passu* with the positions in the *ABCP programme* so that they form overlapping positions and 100% of the commercial paper issued by the *ABCP programme* is covered by *liquidity facilities*. For the purposes of this provision, “overlapping positions” means that the positions represent, wholly or partially, an *exposure* to the same risk such that, to the extent of the overlap, there is a single *exposure*.

[**Note:** *BCD*, Annex IX, Part 4, Point 5]

...

- 9.9.8 R (1) Where a *firm* has two or more overlapping positions in a *securitisation* the *firm* must, to the extent the positions overlap, include in its calculation of *risk weighted exposure amounts* only the position, or portion of a position, producing the higher *risk weighted exposure amounts*. The *firm* may also recognise such an overlap between capital charges for *specific risk* in relation to *positions* in the *trading book* and capital charges for positions in the *non-trading book*, provided that the *firm* is able to calculate and compare the capital charges for the relevant *positions*.

...

9.9.10 G Where BIPRU 9.7.2R(5) applies to securitisation positions in an ABCP programme, the firm may be granted a waiver in the terms described in BIPRU 9.7.4G.

[Note: BCD, Annex IX, Part 4, Point 5]

...

9.11 Calculation of risk-weighted exposure amounts under the standardised approach to securitisations

9.11.1 R Subject to BIPRU 9.11.5R, the risk weighted exposure amount of a ~~rated~~ rated securitisation position or resecuritisation position must be calculated by applying to the exposure value the risk weight associated with the credit quality step with which the credit assessment has been determined to be associated, as prescribed in BIPRU 9.11.2R ~~or BIPRU 9.11.3R.~~

[Note: BCD, Annex IX, Part 4, point 6]

9.11.2 R ~~Table Positions other than ones with short term credit assessments~~

This table belongs to BIPRU 9.11.1R

<i>Credit Quality step</i>	1	2	3	4 (<u>only for credit assessments other than short-term credit assessments</u>)	5 and below <u>All other credit quality steps</u>
<u>Risk weight Securitisation positions</u>	20%	50%	100%	350%	1250%
<u>Resecuritisation positions</u>	<u>40%</u>	<u>100%</u>	<u>225%</u>	<u>650%</u>	<u>1250%</u>

...

[Note: For mapping of the credit quality step to the credit assessments of eligible ECAIs, refer to: www.fsa.gov.uk/pubs/international/ecais_securitisation.pdf]

[Note: BCD, Annex IX, Part 4, point 6, Table 1]

9.11.3 R ~~Table: Positions with short term credit assessments~~

This table belongs to BIPRU 9.11.1R

<i>Credit quality step</i>	1	2	3	All other credit assessments
<i>Risk weight</i>	20%	50%	100%	1250%

[**Note:** For mapping of the *credit quality step* to the credit assessments of eligible *ECAIs*, refer to:

http://www.fsa.gov.uk/pubs/international/ecais_securitisation.pdf] [deleted]

...

9.12 Calculation of risk-weighted exposure amounts under the IRB approach

...

Ratings based method

...

- 9.12.10 R Under the *ratings based method*, the *risk weighted exposure amount* of a ~~rated~~ rated securitisation position or resecuritisation position must be calculated by applying to the *exposure* value the *risk weight* associated with the *credit quality step* with which the credit assessment is associated as prescribed in *BIPRU 9.12.11R* and ~~*BIPRU 9.12.12R*~~ multiplied by 1.06.

[**Note:** *BCD*, Annex IX, Part 4, point 46]

- 9.12.11 R Table: ~~Positions other than ones with short-term credit assessments~~

This table belongs to *BIPRU 9.12.10R*

Credit Quality Step (CQS)		Risk weight Securitisation positions			Resecuritisation positions	
<u>Credit assessments other than short term</u>	<u>Short-term credit assessments</u>	A	B	C	<u>D</u>	<u>E</u>
CQS1	<u>1</u>	7%	12%	20%	<u>20%</u>	<u>30%</u>
CQS 2		8%	15%	25%	<u>25%</u>	<u>40%</u>
CQS 3		10%	18%	35%	<u>35%</u>	<u>50%</u>
CQS 4	<u>2</u>	12%	20%		<u>40%</u>	<u>65%</u>
CQS 5		20%	35%		<u>60%</u>	<u>100%</u>

CQS 6		35%	50%	<u>100%</u>	<u>150%</u>
CQS 7	<u>3</u>	60%	75%	<u>150%</u>	<u>225%</u>
CQS 8		100%		<u>200%</u>	<u>350%</u>
CQS 9		250%		<u>300%</u>	<u>500%</u>
CQS 10		425%		<u>500%</u>	<u>650%</u>
CQS 11		650%		<u>750%</u>	<u>850%</u>
<u>Below CQS 11 all other, unrated</u>		1250%			

[**Note:** For mapping of the *credit quality step* to the credit assessments of eligible *ECAIs*, refer to:
www.fsa.gov.uk/pubs/international/ecais_securitisation.pdf]

[**Note:** *BCD*, Annex IX, Part 4, point 46]

9.12.12 R Table: Positions with short-term credit assessments

This table belongs to *BIPRU 9.12.10R*

Credit Quality Step (CQS)	Risk weight		
	A	B	C
CQS 1	7%	12%	20%
CQS 2	12%	20%	35%
CQS 3	60%	75%	75%
All other credit assessments	1250%	1250%	1250%

[**Note:** For mapping of the *credit quality step* to the credit assessments of eligible *ECAIs*, refer to:
http://www.fsa.gov.uk/pubs/international/ecais_securitisation.pdf] [deleted]

9.12.13 R Subject to *BIPRU 9.12.17R*, the *risk weights* in column A of each table in *BIPRU 9.12.11R* and *BIPRU 9.12.12R* must be applied where the position is in the most senior *tranche* of a *securitisation*. For the purposes of *BIPRU 9.12.10R*:

(1) the weightings in column C of *BIPRU 9.12.11R* must be applied where the *securitisation position* is not a *resecuritisation position* and where the effective number of *exposures* securitised is less than six;

- (2) for the remainder of the securitisation positions that are not resecuritisation positions, the weightings in column B must be applied unless the position is in the most senior tranche of a securitisation, in which case the weightings in column A must be applied; and
- (3) for resecuritisation positions, the weightings in column E must be applied unless the resecuritisation position is in the most senior tranche of the resecuritisation and none of the underlying exposures were themselves resecuritisation exposures, in which case column D must be applied.

[Note: BCD, Annex IX, Part 4, point 47(part)]

...

- 9.12.17 R ~~The risk weights in column C of each table in BIPRU 9.12.11R and BIPRU 9.12.12R must be applied where the position is in a securitisation where the effective number of exposures securitised is less than six. In calculating the effective number of exposures securitised, multiple exposures to one obligor must be treated as one exposure. The effective number of exposures is calculated as:~~

$$N = ((\sum_j (EAD_j))^2) / ((\sum_j (EAD_j^2)))$$

where EAD_j represents the sum of the exposure values of all exposures to the jth obligor. If the portfolio share associated with the largest exposure, C1, is available, the firm may compute N as 1/C1.

[Note: BCD, Annex IX, Part 4, point 49(part)]

- 9.12.18 R ~~In the case of resecuritisation, the firm must look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem. If the portfolio share associated with the largest exposure, C1, is available, the firm may compute N as 1/C1.~~

~~[Note: BCD Annex IX Part 4 point 49 (part)] [deleted]~~

- 9.12.19 R ~~The risk weight in Column B in the tables BIPRU 9.12.11R and BIPRU 9.12.12R must be applied to all other positions.~~

~~[Note: BCD Annex IX Part 4 point 50] [deleted]~~

...

Supervisory formula method

- 9.12.21 R Subject to any permission of the type described in BIPRU 9.12.28G, under the supervisory formula method, the risk weight for a securitisation position must be the greater of 7% or the risk weight to be applied in accordance with BIPRU 9.12.22R. However, the risk weight must be no less than 20% for resecuritisation positions and no less than

7% for all other securitisation positions.

[Note: BCD, Annex IX, Part 4, point 52]

9.12.22 R (1) Subject to any *permission* of the type described in *BIPRU* 9.12.28G, the *risk weight* to be applied to the *exposure* amount must be:

...

...

(19) N is the effective number of *exposures* calculated in accordance with *BIPRU* 9.12.17R – *BIPRU* 9.12.18R. In the case of *resecuritisations*, the *firm* must look at the number of *securitisation exposures* in the pool and not the number of *underlying exposures* in original pools from which the *underlying securitisation exposures* stem.

...

[Note: BCD, Annex IX, Part 4, point 53 (part)]

...

Application

9.15.1 R Subject to *BIPRU* 9.15.1AR, *BIPRU* 9.15 applies to:

- (1) new *securitisations* issued on or after 1 January 2011; and
- (2) from 31 December 2014, to existing *securitisations* where new underlying ~~exposures~~ *exposures* are added or substituted after that date.

[Note: BCD, Article 122a, paragraph 8]

9.15.1A R *BIPRU* 9.15.16AR and *BIPRU* 9.15.16BR only apply to:

- (1) new *securitisations* issued on or after 31 December 2011; and
- (2) from 31 December 2014, to existing *securitisations* where new underlying *exposures* are added or substituted after that date.

9.15.1B G *A credit institution* should have regard to the Committee of European Banking Supervisors' Guidelines to Article 122a of the *Banking Consolidation Directive* when considering its obligations under *BIPRU* 9.3.15R to *BIPRU* 9.3.20R and *BIPRU* 9.15. The Guidelines can be found at <http://www.eba.europa.eu/Publications/Standards-Guidelines.aspx>.

...

9.15.6 R Multiple applications of the retention of net economic interest requirements for any given *securitisation* are ~~prohibited~~ not required.

...

Group level requirements

- 9.15.16A R Subject to *BIPRU 9.15.16BR*, a *credit institution* must ensure that any *undertaking* in relation to which the *credit institution* is a *parent undertaking*:
- (1) becomes exposed to the credit risk of a *securitisation* only where the *originator*, *sponsor* or original lender in the *securitisation* has explicitly disclosed to the *undertaking* that it will retain, on an *ongoing basis*, a material net economic interest which, in any event, must not be less than 5%, as set out in *BIPRU 9.15.3R* to *BIPRU 9.15.10R*;
 - (2) complies before investing in a *securitisation*, and continues to comply thereafter, with the investor due diligence requirements set out in *BIPRU 9.15.11R* to *BIPRU 9.15.13R*; and
 - (3) complies in relation to its investments in *securitisations* with the monitoring requirements set out in *BIPRU 9.15.14R* to *BIPRU 9.15.16R*.
- 9.15.16B R The requirements in *BIPRU 9.15.16AR* do not apply in respect of *subsidiaries* of a *credit institution* which are *insurance undertakings*, *reinsurance undertakings* or *UCITS management companies*.
- 9.15.16C G The purpose of *BIPRU 9.15.16AR* is to ensure that a *credit institution* meets the requirements in *BIPRU 9.15* at *group* level in relation to its *subsidiary undertakings*. In order to comply with this rule, a *credit institution* should be able to demonstrate to the *FSA* that it has put in place adequate *group* policies and procedures which its *subsidiary undertakings* must follow in order to materially meet the requirements for investors set out in *BIPRU 9.15*, and that it regularly monitors compliance with those policies.
- 9.15.16D G Where a *credit institution* applies to the *FSA* for a waiver of *BIPRU 9.15.16AR* in relation to its non-*EEA subsidiary undertakings*, the *FSA* may have regard in its assessment of the waiver tests under section 148 of the *Act* as to whether those *undertakings* are themselves subject to requirements in their jurisdiction similar to those set out in *BIPRU 9.15* and the extent to which complying with such requirements and *BIPRU 9.15.16AR* would be unduly burdensome, including circumstances where it could create a substantial conflict for the *credit institution*.
- 9.15.16E G Without prejudice to *BIPRU 9.15.16AR*, when assessing group risk in accordance with *GENPRU 1.2.30R* a *credit institution* should have regard to the potential risks arising from *securitisation* investment

activities carried out by other undertakings within its group, such as affiliated companies and undertakings in which the credit institution has a participating interest. Where these undertakings are not subject to similar requirements as those set out in BIPRU 9.15, the FSA may seek to address the potential risks arising from this situation for example by imposing a specific capital add-on in the credit institution's ICG.

Consequences of failure to meet requirements

- 9.15.17 G (1) Subject to *BIPRU 9.3.22G, BIPRU 9.15.9R to BIPRU 9.15.10R and BIPRU 9.15.18G*, where a *credit institution* fails to meet any of the requirements in *BIPRU 9.3.18G to BIPRU 9.3.20R* (disclosure requirements), and *BIPRU 9.15.11R to BIPRU 9.15.16R* (investor due diligence requirements) in any material respect by reason of its negligence or omission, the *FSA* will use its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* to impose an additional *risk weight* of no less than 250% (capped at 1250%) of the risk weight that would otherwise apply to the relevant *securitisation positions* under *BIPRU 9.11 to BIPRU 9.14*. The additional *risk weight* imposed will be progressively increased with each relevant, subsequent infringement of the requirements in *BIPRU 9.3.18R to BIPRU 9.3.20R and BIPRU 9.15.11R to BIPRU 9.15.16R*.

[Note: BCD, Article 122a, paragraph 5]

- (2) Subject to *BIPRU 9.3.22G, BIPRU 9.15.9R to BIPRU 9.15.10R and BIPRU 9.15.18G*, where a *credit institution* fails to meet in any material respect the requirements in *BIPRU 9.15.16AR* (Group level requirements), the *FSA* may consider using its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* in the manner described in (1). In order to calculate the *risk weights* that would apply to the *credit institution*, the *FSA* may treat the *securitisation investments* of the *subsidiary undertaking* as if they were *securitisation positions* held directly by the *credit institution*.

...

Disclosure policy

- 11.3.3 R (1) A *firm* must adopt a formal policy to comply with the disclosure requirements laid down in *BIPRU 11.3.1R and BIPRU 11.3.2R* and have policies for assessing the appropriateness of its disclosures, including their verification and frequency.
- (2) A *firm* must also have policies for assessing whether its disclosures convey its risk profile comprehensively to market participants. Where those disclosures do not convey its risk

profile comprehensively to market participants, a firm must publicly disclose the information necessary in addition to that required according to BIPRU 11.3.3R(1). However, a firm may omit one or more items of information if those items are not, in the light of the criterion specified in BIPRU 11.4.1R, regarded as material, or if those items are, in the light of the criteria specified in BIPRU 11.4.2R and BIPRU 11.4.3R, regarded as proprietary or confidential.

[Note: BCD Article 145(3)]

...

Disclosure: Market risk

- 11.5.12 R A firm must disclose its *capital resources requirements* separately for each risk referred to in (1), ~~and (2)~~ and (3):
- (1) in respect of its *trading-book* business, its:
 - (a) *interest rate PRR*;
 - (b) *equity PRR*;
 - (c) *option PRR*;
 - (d) *collective investment schemes PRR*;
 - (e) *counterparty risk capital component*; and
 - (f) *concentration risk capital component*; and
 - (2) in respect of all its business activities, its:
 - (a) *commodity PRR*; and
 - (b) *foreign currency PRR*; and
 - (3) its specific interest-rate risk of securitisation positions.

[Note: BCD Annex XII Part 2 point 9]

Disclosure: Use of VaR model for calculation of market risk capital requirement

- 11.5.13 R The following information must be disclosed by a firm which calculates its *market risk capital requirement* using a *VaR model*:
- (1) for each sub-portfolio covered:
 - (a) the characteristics of the models used;
 - (b) a description of stress testing applied to the sub-

portfolio;

- (c) a description of the approaches used for backtesting and validating the accuracy and consistency of the internal models and modelling process;
 - (d) ~~the highest, the lowest and the mean of the daily *value-at-risk* measures over the reporting period and the *value-at-risk* measure as per the end of the period;~~ for the capital charges calculated according to the *incremental risk charge* and the *all price risk measure* separately, the methodologies used and the risks measured through the use of an internal model, including a description of the approach used by the *firm* to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the model;
 - (e) ~~a comparison of the daily end-of-day *value-at-risk* measures to the one-day changes of the portfolio's value by the end of the subsequent *business day* together with an analysis of any important overshooting during the reporting period;~~
- (2) the scope of the *firm's VaR model permission*; ~~and~~
 - (3) a description of the extent and methodologies for compliance with the requirements set out in *GENPRU 1.3.13R(2)* and *GENPRU 1.3.13R(3)* and *GENPRU 1.3.14R* to *GENPRU 1.3.34R*;
 - (4) the highest, the lowest and the mean of the following:
 - (a) the daily *VaR measures* over the reporting period and the *VaR measure* as per the period end;
 - (b) the *stressed VaR* measures over the reporting period and the *stressed VaR* measure as per the period end;
 - (c) the capital charge according to the *incremental risk charge* over the reporting period and as per the period end;
 - (d) the capital charge according to the *all price risk measure* over the reporting period and as per the period end;
 - (5) the amount of capital according to the *incremental risk charge* and the amount of capital according to the *all price risk measure* shown separately, together with the weighted average

liquidity horizon for each sub-portfolio covered; and

- (6) a comparison of the daily end-of-day *VaR measures* to the one-day changes of the portfolio's value by the end of the subsequent *business day* together with an analysis of any important overshooting during the reporting period.

[Note: BCD Annex XII Part 2 point 10]

...

Disclosures: Securitisation

- 11.5.17 R A firm calculating *risk weighted exposure amounts* in accordance with BIPRU 9 or capital resource requirements according to BIPRU 7.2.48AR to BIPRU 7.2.48KR must disclose the following information, where relevant separately for its *trading book* and *non-trading book*:
- (1) a description of the *firm's* objectives in relation to *securitisation* activity;
 - (1A) the nature of other risks, including *liquidity risk* inherent in securitised assets;
 - (1B) the type of risks in terms of seniority of underlying *securitisation positions* and in terms of assets underlying these latter *securitisation positions* assumed and retained with *resecuritisation* activity;
 - (2) the different roles played by the *firm* in the *securitisation* process;
 - (3) an indication of the extent of the *firm's* involvement in each of them;
 - (3A) a description of the processes in place to monitor changes in the credit and market risk of *securitisation exposures*, including how the behaviour of the underlying assets impacts *securitisation positions* and a description of how those processes differ for *resecuritisation positions*;
 - (3B) a description of the *firm's* policy governing the use of hedging and unfunded protection to mitigate the risks of retained *securitisation* and *resecuritisation positions*, including identification of material hedge counterparties by relevant type of risk exposure;
 - (4) the approaches to calculating *risk weighted exposure amounts* that the *firm* follows for its *securitisation* activities, including the types of *securitisation exposures* to which each approach applies;

- (4A) the types of SSPEs that the firm, as sponsor, uses to securitise third-party exposures, including whether, and in what form, and to what extent, the firm has exposures to these SSPEs, separately for on and off-balance sheet exposures, as well as a list of the entities that the firm manages, or advises, and that invest in either the securitisation positions that the firm has securitised or in SSPEs that the firm sponsors;
- (5) a summary of the firm's accounting policies for securitisation activities, including:
- (a) whether the transactions are treated as sales or financings;
 - (b) the recognition of gains on sales;
 - (c) the methods, key assumptions, inputs and the changes from the previous period for valuing securitisation positions retained interests; and
 - (d) the treatment of synthetic securitisations if this is not covered by other accounting policies;
 - (e) how assets awaiting securitisation are valued and whether they are recorded in the firm's non-trading book or trading book; and
 - (f) policies for recognising liabilities on the balance sheet for arrangements that could require the firm to provide financial support for securitised assets;
- (6) the names of the ECAIs used for securitisations and the types of exposure for which each agency is used;
- (6A) where applicable, a description of the ABCP internal assessment approach as set out in BIPRU 9.12.20R, including the structure of the internal assessment process and relation between internal assessment and external ratings, the use of internal assessment other than for ABCP internal assessment approach capital purposes, the control mechanisms for the internal assessment process (including discussion of independence, accountability, and internal assessment process review), the exposure types to which the internal assessment process is applied and the stress factors used for determining credit enhancement levels, by exposure type;
- (6B) an explanation of significant changes to any of the quantitative disclosures in (8) and (13) to (15) since the last reporting period;
- (7) the total outstanding amount of exposures securitised by the

- firm* and subject to the *securitisation* framework (broken down into *traditional* and *synthetic*), by *exposure* type; [deleted]
- (8) for the *non-trading book* and for *exposures securitised* by the *firm* and subject to the *securitisation* framework, a breakdown by *exposure* type of the amount of impaired and past due *exposures securitised*, and the losses recognised by the *firm* during the current period, broken down by *exposure* type;
- (9) ~~the aggregate amount of *securitisation positions* retained or purchased, broken down by *exposure* type; [deleted]~~
- (10) ~~the aggregate amount of *securitisation positions* retained or purchased:~~
- (a) ~~broken down into a meaningful number of *risk weight* bands; and~~
- (b) ~~with separate disclosure of *positions* that have been *risk weighted* at 1250% or deducted; [deleted]~~
- (11) ~~the aggregate outstanding amount of *securitised revolving exposures* segregated by the *originator's* interest and the investors' interest; and [deleted]~~
- (12) ~~a summary of the *securitisation* activity in the period, including the amount of *exposures securitised* (by *exposure* type), and recognised gain or loss on sale by *exposure* type. [deleted]~~
- (13) separately for the *trading book* and the *non-trading book*, the following information broken down by *exposure* type:
- (a) the total outstanding amount of *exposures securitised* by the *firm*, separately for *traditional securitisations* and *synthetic securitisations*, and *securitisations* for which the *firm* acts only as *sponsor*;
- (b) the aggregate amount of on-balance sheet *securitisation positions* retained or purchased, and off-balance sheet *securitisation exposures*;
- (c) the aggregate amount of assets awaiting *securitisation*;
- (d) for securitised facilities subject to an *early amortisation provision*, the aggregate drawn-down *exposures* attributed to the *originator's* and investors' interests respectively, the aggregate *capital resources requirement* incurred by the *firm* against the *originator's* interest and the aggregate *capital resources requirement* incurred by the *firm* against the investors'

shares of drawn balances and undrawn lines;

- (e) the amount of *securitisation positions* that have been *risk weighted* at 1250% or deducted; and
- (f) a summary of the *securitisation* activity of the current period, including the amount of *exposures securitised* and recognised gain or loss on sale;

(14) separately for the *trading book* and the *non-trading book*, the following information:

- (a) the aggregate amount of *securitisation positions* retained or purchased and the associated *capital resources requirements*, broken down by *securitisation* and *resecuritisation exposures*, and further broken down into a meaningful number of *risk weight* or *capital resources requirement* bands, for each *capital resources requirement* approach used; and
- (b) the aggregate amount of *resecuritisation exposures* retained or purchased, broken down according to the *exposure* before and after hedging or insurance, and the *exposure* to financial guarantors, broken down according to guarantor credit worthiness categories or guarantor name; and

(15) for the *trading book*, the total outstanding *exposures securitised* by the *firm* and subject to a *market risk capital requirement*, broken down into *traditional* and *synthetic*, and by *exposure type*.

[Note: BCD Annex XII Part 2 point 14]

...

- 14.2.6 R In the case of a credit default swap, a *firm* the *exposure* of which arising from the swap represents a long position in the underlying may use a figure of 0% for potential future credit *exposure*, unless the credit default swap is subject to closeout upon the insolvency of the entity the *exposure* of which arising from the swap represents a short position in the underlying, even though the underlying has not defaulted, in which case the potential for future credit *exposure* of the *firm* must be limited to the amount of premia which are not yet paid by the entity to the *firm*.

[Note: CAD Annex II point 7]

...

Treatment of expected loss amounts under the IRB approach

- 14.2.18 R Where a *firm* calculates *risk weighted exposure amounts* for the purposes of *BIPRU* 14 in accordance with the *IRB approach*, then for the purposes of the calculation provided for in *BIPRU* 4.4.79R (~~Double default~~) 4.3.8R, the following will apply:

...

...

Transitional Provisions

TP 4 Pre CRD capital requirements applying on a solo basis during 2007: Banks

...

- 4.36 G Any reference to a *qualifying debt security* ~~or *qualifying equity*~~ in a part of *BIPRU* that applies during 2007 should be interpreted in accordance with *IPRU(BANK)*. However *BIPRU* 7.2.50R (Must not apply *qualifying debt security* treatment to risky assets) also applies.

...

- 4.43 G The ~~definitions~~ definition of *qualifying debt security* ~~and *qualifying equity*~~ in the *Glossary* ~~apply~~ applies if the security or obligor in question comes within the scope of a *firm's IRB permission*.

...

TP 6 Pre CRD capital requirements applying on a solo basis during 2007: Investment management firms

...

- 6.24 R Any reference to a *qualifying debt security* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the meaning it has when used in section A of Table 5.2.3(5)(b) of chapter 5 of *IPRU(INV)* (Position risk requirement for qualifying debt securities). However *BIPRU* 7.2.50R (Must not apply *qualifying debt security* treatment to risky assets) also applies. ~~Any reference to a *qualifying equity* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the *Glossary* to chapter 10 of *IPRU(INV)*.~~

- 6.25 G The reason for *BIPRU* TP 6.23R and *BIPRU* TP 6.24R is that the calculation of the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7 (Market risk) involves the use of the *standardised approach* to credit risk. The *specific risk rules* therefore need to be adjusted for a *firm* that is not using the *standardised approach* to credit risk in 2007 so as to apply the pre-2007 method of calculating *specific risk*. However chapter 5 does not use the concept of *specific risk*. The nearest equivalent is in chapter 10 of *IPRU(INV)* (*Securities and futures firms*).

~~The definition of *qualifying equity* also depends in part on the *standardised approach* to credit risk.~~

...

- 6.34 R The definition of *qualifying debt security* ~~and *qualifying equity*~~ in the *Glossary* ~~apply~~ applies if the security or obligor in question comes within the scope of a *firm's IRB permission*.

...

TP 8 Pre CRD capital requirements applying on a solo basis during 2007: Securities and futures firms

...

- 8.30 R Any reference to a *qualifying debt security* ~~or *qualifying equity*~~ in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the *Glossary* to chapter 10 of *IPRU(INV)*. However *BIPRU 7.2.50R* (Must not apply *qualifying debt security* treatment to risky assets) also applies.

- 8.31 G The effect of *BIPRU TP 8.29R* and *BIPRU TP 8.30R* is that a *firm* should apply *rules 43R to 47R* of Appendix 4 of Chapter 10 of *IPRU(INV)* (Specific risk portion of interest rate PRR) instead of *BIPRU 7.2.43R to BIPRU 7.2.49R* (Specific risk portion of interest rate PRR). The reason for this is that the calculation of the *specific risk* portion of the *interest rate PRR* under *BIPRU 7* (Market risk) involves the use of the *standardised approach* to credit risk. The *specific risk rules* therefore need to be adjusted for a *firm* that is not using the *standardised approach* to credit risk in 2007 so as to apply the pre-2007 method of calculating *specific risk*. ~~The definition of *qualifying equity* also depends in part on the *standardised approach* to credit risk.~~

...

- 8.38 R ~~The definitions~~ definition of *qualifying debt security* ~~and *qualifying equity*~~ in the *Glossary* ~~apply~~ applies if the security or obligor in question comes within the scope of a *firm's IRB permission*.

TP 9 Pre CRD capital requirements applying on a solo basis during 2007 and capital floors: Personal investment firms

...

- 9.36 R Any reference to a *qualifying debt security* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the *Glossary* to chapter 13 of *IPRU(INV)*. However *BIPRU 7.2.50R* (Must not apply *qualifying debt security* treatment to risky assets) also applies. ~~Any reference to a *qualifying equity* in a part of~~

~~*BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the Glossary to chapter 10 of *IPRU(INV)*.~~

- 9.37 R The reason for *BIPRU* TP 9.35R and *BIPRU* TP 9.36R is that the calculation of the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7 (Market risk) involves the use of the *standardised approach* to credit risk. The *specific risk rules* therefore need to be adjusted for a *firm* that is not using the *standardised approach* to credit risk in 2007 so as to apply the pre-2007 method of calculating *specific risk*. However chapter 13 does not distinguish between *specific risk* and *general market risk*. The nearest equivalent is in chapter 10 of *IPRU(INV)* (*Securities and futures firms*). ~~The definition of *qualifying equity* also depends in part on the *standardised approach* to credit risk.~~

...

- 9.44 R The definition of *qualifying debt security* and ~~*qualifying equity*~~ in the *Glossary* ~~apply~~ applies if the security or obligor in question comes within the scope of a *firm's IRB permission*.

...

TP 14 Market risk: VaR models

...

14.4 R A *firm* may treat:

...

- (2) the *incremental default risk charge* as being replaced by the provisions of that written concession relating to the calculation of capital requirements for *specific risk*.

...

Sch 2 Notification and reporting requirements

...

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				
<u><i>BIPRU</i> 7.2.48B</u>	<u>Total sum of a <i>firm's</i> weighted net long and net short securitisation and resecuritisation positions, broken down by types of underlying assets</u>	<u>Total sum of a <i>firm's</i> weighted net long and net short securitisation and resecuritisation positions, broken down by types of underlying assets</u>	<u>Periodically as set out in <i>SUP</i> 16.12</u>	<u>In accordance with <i>SUP</i> 16.12</u>
...				
<u><i>BIPRU</i> 7.10.55 ZAR</u>	<u>Material shortfall in the amount of capital required under the <i>all price risk measure</i> identified as a result of performing the stress tests under <i>BIPRU</i> 7.10.55ZR</u>	<u>Information about the stress tests and the material shortfall in capital</u>	<u>Existence of a material shortfall in capital</u>	<u>No later than two <i>business days</i> after the <i>business day</i> on which the material shortfall occurred</u>
...				
<u><i>BIPRU</i> 7.10.130R</u>	<u>Details of significant planned changes to</u>	<u>Information about the nature of the change and an</u>	<u>Intention to change</u>	<u>Prior to any changes being</u>

	the <i>VaR model</i>	estimate of the impact on <i>VaR numbers</i> and the <i>incremental default risk charge</i>		implemented
--	----------------------	---	--	-------------

...

Annex D

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

16.12 Integrated Regulatory Reporting

...

Regulated Activity Group 1

16.12.5 R The applicable *data items* and forms or reports referred to in SUP 16.12.4R are set out according to *firm* type in the table below:

...	
Note 23	Only applicable to <i>firms</i> that hold <i>securitisation positions</i> ; <u>in the trading book and/or</u> are the <i>originator</i> or <i>sponsor</i> of <i>securitisations</i> of trading book exposures <u>held in the trading book.</u>

...

Regulated Activity Group 3

...

16.12.11 R The applicable *data items* referred to in SUP 16.12.4R are set out according to *firm* type in the table below:

...	
Note 32	Only applicable to <i>firms</i> that hold <i>securitisation positions</i> ; <u>in the trading book and/or</u> are the <i>originator</i> or <i>sponsor</i> of <i>securitisations</i> of trading book exposures <u>held in the trading book.</u>
...	

...

Regulated Activity Group 4

...

16.12.15 R The applicable *data items* referred to in SUP 16.12.4R according to type of *firm* are set out in the table below:

...	
Note 29	Only applicable to <i>firms</i> that hold <i>securitisation positions</i> ; <u>in the trading book and/or</u> are the <i>originator</i> or <i>sponsor</i> of <i>securitisations</i> of trading book exposures <u>held in the trading book.</u>
...	

...

Regulated Activity Group 7

...

16.12.22A R The applicable *data items* referred to in SUP 16.12.4R are set out according to type of *firm* in the table below:

...	
Note 22	Only applicable to <i>firms</i> that hold <i>securitisation positions</i> ; <u>in the trading book</u> and/or are the <i>originator</i> or <i>sponsor</i> of <i>securitisations</i> of trading book exposures <u>held in the trading book</u> .
...	

...

Regulated Activity Group 8

...

16.12.25A R The applicable *data items* referred to in SUP 16.12.4R are set out according to type of *firm* in the table below:

...	
Note 27	Only applicable to <i>firms</i> that hold <i>securitisation positions</i> ; <u>in the trading book</u> and/or are the <i>originator</i> or <i>sponsor</i> of <i>securitisations</i> of trading book exposures <u>held in the trading book</u> .
...	

...

SUP 16 Annex 24 Data items for SUP 16.12

...

FSA005

Market risk

Note: In this table numerical references correspond with those shown on the online submission form and are not presented here in strict numerical order.

	A	B	C	D	E	F	G
	USD	GBP	EUR	CHF	YEN	Other	Total
Interest rate risk							
General interest rate risk							
1							
2							
3							
Specific interest rate risk							
Amount by risk bucket							
4							
5							
6							
7							
8							
9							
10							
11							
66							
67							
68							
69							
12							
13							
14							
15							
16							
17							
70							
71							
18							
Equity risk							
General equity risk (or simplified)							
19							
20							
21							

FSA005 continued

	A	B	C	D	E	F	G
	USD	GBP	EUR	CHF	YEN	Other	Total
Specific equity risk by risk bucket							
22 Qualifying equities							
23 Qualifying equity indices							
24 Other equities, indices or equity baskets							
82 All equities, and other equity indices or equity baskets							
63 65 Convertibles adjustment							
25 PRR							
26 Option PRR for equity positions							
27 CAD 1 PRR for equity positions							
28 Other PRR							
29 Total Equity PRR							
Commodity Risk							
	Precious metals	Base metals	softs	energy	other		Total
30 Valuation of longs							
31 Valuation of shorts							
32 Outright PRR							
33 Spread PRR							
34 Carry PRR							
35 Simplified PRR							
36 Total PRR							
37 Option PRR for commodity positions							
38 CAD 1 PRR for commodity positions							
39 Other PRR							
40 Total Commodity PRR							
Foreign currency risk							
General foreign currency risk							
	USD	GBP	EUR	CHF	YEN	Other	Total
41 Total net long positions							
42 Total net short positions							
43 Net gold position							
44 PRR							

FSA005 continued

	A USD	B GBP	C EUR	D CHF	E YEN	F Other	G Total
45							
46							
47							
48							

Collective investment undertaking risk

	USD	GBP	EUR	CHF	YEN	Other	Total
49							
50							
51							
52							
53							
54							
55							

Other PRR

56							
----	--	--	--	--	--	--	--

Internal models-based charges

57							
58							
59							
60							
72							
73							
74							
75							
76							
77							
78							
79							
80							
81							

FSA005 continued

Add-ons

		A	B
		Description	Value
63	1		
	2		
	3		
	...		
	n		

64 Total Add-ons

61 Internal models-based PRR

62 GRAND TOTAL PRR

•••

FSA046
Securitisation: Non-Trading Book

General Transaction level information – Where the firm is an originator or sponsor

	A
1	Location of the most recent Pillar 3 disclosures for securitisation (BIPRU 11.5.17R)
2	Additional capital requirements for significant risk transfer (BIPRU 9.3.1R)
21	Additional capital requirements (BIPRU 9.3.21G and BIPRU 9.15.17G)
22	Reduction in RWAs according to BIPRU 9.10.4R and BIPRU 9.10.6R

Transaction level information - Where the firm is an originator or sponsor

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
	Programme Name	Asset class	Originator's Interest	Investors' Interest	Location of Investor Reports	Assets appear on FSA001?	BIPRU 9.3.1R Applied?	Conversion Factor applied?	Exposure value before securitisation	Capital requirement before securitisation	Exposure value after securitisation	Exposure value deducted from capital resources	Capital requirement after securitisation before cap	Capital requirement after securitisation after cap	Retention of net economic interest (% to 2dp)	Method of retention of net economic interest
3																
1																
...																
n																

Risk positions - standardised exposures

	A	B	C	D	E	F
	CQS1	CQS2	CQS3	CQS4 (only for credit assessments other than short-term credit assessments)	All other credit assessments	Deductions from capital
4						
5	Originator					
6	Sponsor					
7	Counterparty credit risk					
	All other exposures					

	A	B	C	D	E	F	G	H
	CQS1	CQS2	CQS3	CQS4 (only for credit assessments other than short-term credit assessments)	All other credit assessments	Deductions from capital	Concentration ratio (Exposure value)	Concentration ratio (Capital requirement)
31								
32	Originator	Securitisation						
33		Resecuritisation						
34	Sponsor	Securitisation						
35		Resecuritisation						
36	Counterparty credit risk	Securitisation						
37		Resecuritisation						
38	All other exposures	Securitisation						
		Resecuritisation						

FSA046 (cont)
Securitisation: Non-Trading Book

Risk positions - IRB exposures

		B	C	D	E	F	G	H	I	J	K	L	M	N	P	O
		CQS1 ST CQS1	CQS2	CQS3	CQS4 ST CQS2	CQS5	CQS6	CQS7 ST CQS3	CQS8	CQS9	CQS10	CQS11	Below CQS11 All other credit assessments	Supervisory formula (Exposure Value)	Supervisory formula (Capital Requirement)	Deductions from capital
8	Originator	A														
9		B														
10		C														
23		D														
24		E														
11	Sponsor	A														
12		B														
13		C														
25		D														
26		E														
14	Counterparty credit risk	A														
15		B														
16		C														
27		D														
28		E														
17	All other exposures	A														
18		B														
19		C														
29		D														
30		E														

...

FSA058
Securitisation: Trading Book

General Transaction level information - Where the firm is an originator or sponsor

1	Location of the most recent Pillar 3 disclosures for securitisation (BIPRU 11.5.17R)	A
21	Additional capital requirements (BIPRU 7.2.47HG-BIPRU 7.2.48IG)	

Non-correlation trading portfolio securitisations

Transaction level information - Where the firm is an originator or sponsor

	A	B	C	D	E	F	O	P
3	Programme Name	Asset class	Originator's Interest	Investors' Interest	Location of Investor Reports	Assets appear on FSA001?	Retention of net economic interest (% to 2dp)	Method of retention of net economic interest
1								
...								
n								

[Insert the following tables as new Data Elements for Data Item FSA058. The text is not underlined.]

Risk positions - standardised exposures (net positions)

	A	B	C	D	E	F	
		CQS1	CQS2	CQS3	CQS4 (only for credit assessments other than short-term credit assessments)	All other credit assessments	Deductions from capital
31	Originator	Securitisation					
32		Resecuritisation					
33	Sponsor	Securitisation					
34		Resecuritisation					
35	Counterparty credit risk	Securitisation					
36		Resecuritisation					
37	All other exposures	Securitisation					
38		Resecuritisation					

Risk positions - IRB exposures (net positions)

	B	C	D	E	F	G	H	I	J	K	L	M	N	P	O
	CQS1	CQS2	CQS3	CQS4	CQS5	CQS6	CQS7	CQS8	CQS9	CQS10	CQS11	Below CQS11	Supervisory formula (Exposure Value)	Supervisory formula (Capital Requirement)	Deductions from capital
	ST CQS1			ST CQS2			ST CQS3					All other credit assessments			
8	Originator	A													
9		B													
10		C													
23		D													
24		E													
11	Sponsor	A													
12		B													
13		C													
25		D													
26		E													
14	Counterparty credit risk	A													
15		B													
16		C													
27		D													
28		E													
17	All other exposures	A													
18		B													
19		C													
29		D													
30		E													

FSA058 (cont)

Securitisation: Trading Book

Total capital requirement (net long positions plus net short positions) broken down by underlying assets

		A
		Capital requirement
39	Residential mortgages	
40	Commercial mortgages	
41	Credit cards	
42	Leasing	
43	Loans to corporates	
44	Consumer loans	
45	Trade receivables	
46	Securitisations	
47	Other	

Correlation trading portfolio positions

Risk positions - standardised exposures (net positions)

	A	B	C	D	E	F
	CQS1	CQS2	CQS3	CQS4 (only for credit assessments other than short-term credit assessments)	All other credit assessments	Deductions from capital
48	Originator					
49	Sponsor					
50	Counterparty credit risk					
51	All other exposures					

Risk positions - IRB exposures (net positions)

		B	C	D	E	F	G	H	I	J	K	L	M	N	P	O
		CQS1	CQS2	CQS3	CQS4	CQS5	CQS6	CQS7	CQS8	CQS9	CQS10	CQS11	Below CQS11	Supervisory formula (Exposure Value)	Supervisory formula (Capital Requirement)	Deductions from capital
		ST CQS1			ST CQS2			ST CQS3					All other credit assessments			
52	Originator	A														
53		B														
54		C														
55	Sponsor	A														
56		B														
57		C														
58	Counterparty credit risk	A														
59		B														
60		C														
61	All other exposures	A														
62		B														
63		C														

.....

SUP 16 Annex 25G Guidance notes for data items in SUP 16 Annex 24R

...

FSA003 – Capital Adequacy

...

103A Concentration risk capital component

This is the CNCOM. See ~~BIPRU 10.5.14R to BIPRU 10.5.21G~~ BIPRU 10.10A.4G to BIPRU 10.10A.12R for details of how this is calculated.

Figures appearing here should also appear on FSA008 under data element 5R for the same quarterly reporting date.

...

FSA005 – Market risk

....

~~11~~ ~~Securitisation exposures/unrated liquidity facilities PRR~~

See ~~BIPRU 7.2.47R.~~

~~[CEBS' MKR SA TDI item 3.5, column 9]~~

66 Net long securitisation (excl. re-securitisation) exposures/unrated liquidity facilities PRR

See BIPRU 7.2.48AR to BIPRU 7.2.48KR.

67 Net short securitisation (excl. re-securitisation) exposures/unrated liquidity facilities PRR

See BIPRU 7.2.48AR to BIPRU 7.2.48KR.

68 Net long re-securitisation exposures/unrated liquidity facilities PRR

See BIPRU 7.2.48AR to BIPRU 7.2.48KR.

69 Net short re-securitisation exposures/unrated liquidity facilities PRR

See BIPRU 7.2.48AR to BIPRU 7.2.48KR.

12 Ordinary CDS (outside correlation trading portfolio) PRR

See BIPRU 7.11

[Part of CEBS' MKR SA TDI item 3, columns 6 and 7]

13 Securitisation CDS (outside correlation trading portfolio) PRR

See *BIPRU 7.11.35R*

[*Part of CEBS' MKR SA TDI item 3, columns 6 and 7*]

...

17 Other PRR for interest rate risk

Where a 'prudent' uplift is required under *BIPRU 7.2.46R* or PRR arising from other non-standard transactions as required by *BIPRU ~~7.1.7R~~ 7.1.9R* to *BIPRU ~~7.1.13E~~ 7.1.16E* and that is attributable to interest rate risk

70 Correlation trading portfolio - Net long positions PRR

See *BIPRU 7.2.42A R* to *BIPRU 7.2.42DR* and *BIPRU 7.2.48LR*.

71 Correlation trading portfolio - Net short positions PRR

See *BIPRU 7.2.42A R* to *BIPRU 7.2.42DR* and *BIPRU 7.2.48LR*.

18 Total interest rate PRR

This is the sum of the general interest rate, specific interest rate, ~~securitisation~~ *securitisation* exposures/unrated liquidity facilities, *re-securitisation positions / unrated liquidity facilities*, ordinary CDS, ~~securitisation~~ *securitisation* CDS, basic interest rate, options, CAD1, and other PRRs, and *correlation trading portfolio positions*.

This will have the same value as data element 96A in FSA003.

[*CEBS' MKR SA TDI column 9 total less item 4 column 9*]

Equity risk

...

~~22~~ Qualifying equities

Enter the valuation of the instruments. See *BIPRU 7.3.35R* to *BIPRU 7.3.37G*.
[*CEBS' MKR SA EQU item 2.1, column 6*]

23 Qualifying equity indices

Enter the valuation of the instruments. See *BIPRU 7.3.38R* to *BIPRU 7.3.39R*.

~~24~~ Other equities

Enter the valuation of all other equities, equity indices or equities baskets.

[*CEBS' MKR SA EQU item 2.2, column 6*]

82 All equities, and other equity indices or equity baskets

Enter the valuation of all equities, other equity indices or equities baskets. See *BIPRU 7.3.31G* to *BIPRU 7.3.34R*.

...

Internal models-based chargesSee *BIPRU* 7.10.

...

59 Average of previous 60 days VaRThis equates to item (3) in *BIPRU* 7.10.117G.[*CEBS' MKR IM total positions column 1 divided by total positions column 7*]**~~60 Incremental default risk charge~~**This is the incremental default risk charge under *BIPRU* 7.10.116R. It also includes the specific risk surcharge under *BIPRU* 7.10.127G.[*CEBS' MKR IM total positions columns 3 and 4*]**72 SVaR Multiplier**See *BIPRU* 7.10.118R to *BIPRU* 7.10.126G.**73 Latest SVaR**See *BIPRU* 7.10.27AR**74 Average of previous 60 days SVaR**See *BIPRU* 7.10.27AR and *BIPRU* 7.10.117G items (6) and (8).**75 Latest Incremental Risk Charge**See *BIPRU* 7.10.116R**76 Average of previous 12 weeks Incremental Risk Charge**See *BIPRU* 7.10.116R and *BIPRU* 7.10.117G items (10) and (11)**77 Latest All Price Risk Measure**See *BIPRU* 7.10.55TR to *BIPRU* 7.10.55YR and *BIPRU* 7.10.116AR**78 Average of previous 12 weeks All Price Risk Measure**

See BIPRU 7.10.55TR to BIPRU 7.10.55YR, BIPRU 7.10.116AR and BIPRU 7.10.117G items (13) and (14)

79 Standard Rules charge for net long correlation trading portfolio products in APR model

Firms should report the total standard rules capital charge before multiplying the charge by the APR floor charge (8%). The APR floor charge is reported in data element 81.

See BIPRU 7.10.55UR

80 Standard Rules charge for net short correlation trading portfolio products in APR model

Firms should report the total standard rules capital charge before multiplying the charge by the APR floor charge (8%). The APR floor charge is reported in data element 81.

See BIPRU 7.10.55UR

81 All Price Risk Floor Charge

See BIPRU 7.10.55UR

61 Internal models-based PRR

~~See BIPRU 7.10.113R to BIPRU 7.10.117G.~~

~~This will have the same value as data element 102A on FSA003.~~

~~{CEBS' MKR IM total positions column 5}~~

This is the sum of the VaR capital charge, stressed VaR (SVaR) capital charge, incremental risk charge, all price risks measure and any internal models add-ons. See BIPRU 7.10.113R to BIPRU 7.10.117G.

This will have the same value as data element 102A in FSA003.

...

64 Total Add-ons

The total of items 1 to n in 63

FSA005 – Market risk validations**Internal validations**

Data elements are referenced by row then column.

Validation number	Data element		
1	3G	=	3A + 3B + 3C + 3D + 3E + 3F
2	10G	=	10A + 10B + 10C + 10D + 10E + 10F
3	18G	=	18A + 18B + 18C + 18D + 18E + 18F
4			[deleted – replaced by validation 52]
5			[deleted]
6			[deleted]
7	25G	=	(22G * 2%) + (24G * 4%) + (23G * 2%) [deleted – replaced by validation 56]
8			[deleted]
...			
52	18G	=	3G + 10G + 11G + 12G + 13G + 14G + 15G + 16G + 17G [deleted – replaced by validation 57]
53	64G	=	SUM (63B)
<u>54</u>	<u>81G</u>	<u>≡</u>	<u>Higher of (79G * 8%, 80G * 8%)</u>
<u>55</u>	<u>61G</u>	<u>≡</u>	<u>Higher of (58G, 59G * 57G) + higher of (73G, 74G * 72G) + higher of (75G, 76G) + higher of (77G, 78G, 81G) + 64G</u>
<u>56</u>	<u>25G</u>	<u>≡</u>	<u>(82G * 8%) + (23G*0%) + 65G</u>
<u>57</u>	<u>18G</u>	<u>≡</u>	<u>3G + 10G + 12G + 13G + 14G + 15G + 16G + 17G + higher of (66G + 68G, 67G + 69G) + higher of (70G, 71G)</u>
<u>58</u>	<u>57G</u>	<u>≥</u>	<u>3.00 (if element 57G is reported)</u>
<u>59</u>	<u>72G</u>	<u>≥</u>	<u>3.00 (if element 72G is reported)</u>

FSA008 – Large Exposures

...

5R CNCOM

The amount of CNCOM calculated as set out in ~~BIPRU 10.10.4G to 10.10.10R~~ BIPRU 10.10A.4G to BIPRU 10.10A.10R (or *BIPRU 10.5.16G to 10.5.24G* for those utilising TP 33). It should agree with the amount reported in data element 103A on FSA003 for the same reporting date, except when the firm is a member of a *UK integrated group/core UK group* when there may be some additional CNCOM attributable to the firm.

...

FSA046 – Securitisation – non-trading book

...

Risk positions – standardised exposures

All *exposures* that are treated under *BIPRU 9.11* should be shown in this section, broken down by credit quality, ~~and~~ how the *exposure* arose, and whether the position is a securitisation or re-securitisation.

Row 4 31 & 32 : Originator

This is for *exposures* where the *firm* originated the underlying assets.

Row 5 33 & 34: Sponsor

This is for *exposures* to *Asset backed commercial paper programmes*.

Row 6 35 & 36: Counterparty credit risk

This is the *exposure* values generated under *BIPRU 13*.

Row 7 37 & 38: All other exposures

This is for any standardised *exposures* not included in *data elements* ~~4–6~~ 31 – 38 above.

Columns A – E

Positions should be split by credit rating according to *BIPRU 9.11.2R* and *BIPRU 9.11.3R*.

Column F

This is for positions deducted from capital at part 1 of stage M of the capital calculations in *GENPRU 2*, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Column G

Firms should state the exposure value of securitisation positions for which risk weighted exposure amounts are calculated under BIPRU 9.11.6R to BIPRU 9.11.7G.

Column H

Firms should state the capital requirement for *securitisation positions* for which *risk weighted exposure amounts* are calculated under *BIPRU 9.11.6R* to *BIPRU 9.11.7G*.

Risk positions – IRB exposures

All *exposures* that are treated under *BIPRU 9.12* should be shown in this section, broken down by credit quality, granularity and how the *exposure* arose.

Rows 8 – 10 & 23 -24: Originator

This is for *exposures* where the *firm* originated the underlying *exposures*.

Rows 11 – 13 & 25 - 26: Sponsor

This is for *exposures* to *Asset backed commercial paper programmes*.

Rows 14 – 16 & 27 - 28: Counterparty credit risk

This is for exposure values generated under *BIPRU 13* where the *exposure* is also a *securitisation* position.

Rows 17 – 19 & 29 - 30: All other exposures

This covers any IRB *exposures* not included above.

Columns B – M

This should be split by credit rating according to *BIPRU 9.12.11R* and *BIPRU 9.12.12R*.

Column N

Firms should state the ~~exposure~~ *exposure* value calculated under *BIPRU 9.12.21R* to *BIPRU 9.12.23R*.

Column O

This is for positions deducted from capital at part 1 of stage M of the capital calculations in *GENPRU 2*, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Column P

Firms should state the capital requirement calculated under *BIPRU 9.12.21R* to *BIPRU 9.12.23R*.

...

FSA058 – Securitisation – trading book

This data item allows a greater understanding of the prudential risk profile of the *firm*. It also enables the *FSA* to lead debate on credit risk transfer in international discussions.

This data item captures information on the *firm's trading book securitisation positions* which fall under *BIPRU 7.2* where they are acting as *originator*, *sponsor* or *investor*. *Non-trading book securitisations* are captured in FSA046.

The data item has been separated into three sections:

- general trading book securitisation information;

- information on non-correlation trading portfolio securitisations, and
- correlation trading portfolio securitisations.

Currency

You should report in the currency of your annual audited accounts i.e. in Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Non-correlation trading portfolio securitisations

Transaction level information - Where the firm is an originator or sponsor

All securitisations, on a cumulative basis, where you have acted as an *originator* or *sponsor* where the assets are held in the *trading book* should be shown in this section, irrespective of whether you meet *BIPRU* 9.3.1R.

...

After the entry for “3P – Method of retention of net economic interest” insert the following new text which is not underlined.

Risk positions – standardised exposures

All *non-correlation trading portfolio securitisation positions* that are treated under *BIPRU* 7.2.48DR should be shown in this section, broken down by credit quality, how the *exposure* arose, and whether the position is a *securitisation* or *resecuritisation*.

Row 31 & 32: Originator

This is for *exposures* where the *firm* originated the underlying assets.

Row 33 & 34: Sponsor

This is for *exposures* where the firm acts as a *sponsor*.

Row 35 & 36: Counterparty credit risk

This is the *exposure* values generated under *BIPRU* 13.

Row 37 & 38: All other exposures

This is for any standardised *exposures* not included in *data elements* 31 – 38 above. For example, a firm that is an investor in *trading book securitisations*.

Columns A – E

Positions should be split by credit rating according to *BIPRU* 7.2.48DR.

Column F

This is for *positions* deducted from capital at part 1 of stage M of the capital calculations in *GENPRU 2*, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Risk positions – IRB exposures

All *exposures* that are treated under *BIPRU 7.2.48ER* should be shown in this section, broken down by credit quality, granularity and how the *exposure* arose.

Rows 8 – 10 & 23 -24: Originator

This is for *exposures* where the *firm* originated the underlying *exposures*.

Rows 11 – 13 & 25 - 26: Sponsor

This is for *exposures* where the firm acts as a *sponsor*.

Rows 14 – 16 & 27 - 28: Counterparty credit risk

This is for exposure values generated under *BIPRU 13* where the *exposure* is also a *securitisation position*.

Rows 17 – 19 & 29 - 30: All other exposures

This covers any *IRB exposures* not included above. For example, a *firm* that is an investor in *trading book securitisations*.

Columns B – M

This should be split by credit rating according to *BIPRU 7.2.48ER*.

Column N

Firms should state the exposure value calculated under *BIPRU 7.2.48AR* to *BIPRU 7.2.48CR*.

Column O

This is for *positions* deducted from capital at part 1 of stage M of the capital calculations in *GENPRU 2*, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Column P

Firms should state the capital requirement calculated under *BIPRU 7.2.48FR*.

Total capital requirement (net long positions plus net short positions) broken down by underlying assets

Rows 39 – 47:

Enter the total capital requirement (net long positions & net short positions) broken down by underlying assets as shown.

Correlation trading portfolio positions

Risk positions – standardised exposures

All *correlation trading portfolio securitisation positions* that are treated under *BIPRU 7.2.48DR* should be shown in this section, broken down by credit quality and how the *exposure* arose.

Row 48: Originator

This is for *exposures* where the *firm* originated the underlying assets.

Row 49: Sponsor

This is for *exposures* where the *firm* acts as a sponsor.

Row 50: Counterparty credit risk

This is the exposure values generated under *BIPRU 13*.

Row 51: All other exposures

This is for any standardised *exposures* not included in *data elements 48 - 50* above. For example, a *firm* that is an investor in *correlation trading portfolio positions*.

Columns A – E

Positions should be split by credit rating according to *BIPRU 7.2.48DR*.

Column F

This is for *positions* deducted from capital at part 1 of stage M of the capital calculations in *GENPRU 2*, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Risk positions – IRB exposures

All *exposures* that are treated under *BIPRU 7.2.47ER* should be shown in this section, broken down by credit quality, granularity and how the *exposure* arose.

Rows 52 - 54: Originator

This is for *exposures* where the *firm* originated the underlying *exposures*.

Rows 55 - 57: Sponsor

This is for *exposures* where the *firm* acts as a sponsor.

Rows 58 - 60: Counterparty credit risk

This is for exposure values generated under *BIPRU 13* where the *exposure* is also a *securitisation position*.

Rows 61 - 63: All other exposures

This covers any *IRB exposures* not included above. For example, a *firm* that is an investor in *correlation trading portfolio positions*.

Columns B – M

This should be split by credit rating according to *BIPRU 7.2.48E R*.

Column N

Firms should state the exposure value calculated under *BIPRU 7.2.48AR* to *BIPRU 7.2.48CR*.

Column O

This is for positions deducted from capital at part 1 of stage M of the capital calculations in *GENPRU 2*, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Column P

Firms should state the capital requirement calculated under *BIPRU 7.2.48FR*.

PUB REF: 002727

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