

2 Draft amendments to Supervisory Statement 11/13 – ‘Internal Ratings Based (IRB) Approaches’

In this appendix, new text is underlined and deleted text is struck through. It is proposed these changes will take effect from Saturday 1 January 2022.

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1 Introduction

1.1 This Supervisory Statement (SS) is aimed at firms to which ~~CRD-IV~~the Capital Requirements Regulation¹ applies.

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~~1.4 Firms should be aware that where approval to use the IRB approach is subject to a joint decision under CRR Article 20, the expectations set out in this supervisory statement will be subject to discussion between the PRA and other EEA regulators regarding the joint decision.~~

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~~1.6 Some parts of this supervisory statement will require revision in due course as a result of the development by the EBA of binding technical standards required by the CRR. The PRA expects to amend or delete these parts of this supervisory statement when those technical standards enter into force.~~

~~1~~¹~~Capital Requirements Directive (2013/36/EU)(CRD) and Capital Requirements Regulation (575/2013)~~(575/2013) UK Law (CRR) – jointly ‘CRD-IV’.

1.8 Where this SS refers to EBA Guidelines, these are to the versions as they stood at the end of the transition period following the UK’s withdrawal from the EU. The PRA does not expect firms to comply with changes to those Guidelines that the EBA makes after the end of the transition period (11pm on Thursday 31 December 2020).

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2 Application of requirements to ~~EEA~~UK groups applying the IRB approach on a unified basis

2.1 The CRR provides that where the IRB approach is used on a unified basis by an ~~EEA~~UK group, the PRA is required to permit certain IRB requirements to be met on a collective basis by members of that group. The PRA considers that where a firm is reliant upon a rating system or data provided by another member of its group it will not meet the condition that it is using the IRB approach on a unified basis unless:

(a) the firm only does so to the extent that it is appropriate, given the nature and scale of the firm’s business and portfolios and the firm’s position within the group;

(b) the integrity of the firm’s systems and controls is not adversely affected;

(c) the outsourcing of these functions meets the requirements of SYSC; and

(d) the abilities of the PRA and the lead regulator of the group to carry out their responsibilities under the CRR are not adversely affected.

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5 Corporate governance

5.1 Where a firm's rating systems are used on a unified basis pursuant to CRR Article 20(6), the PRA considers that the governance requirements in CRR Article 189 can be met only if the subsidiary undertakings have delegated to the governing body or designated committee of the ~~EEAUK~~ parent institution, ~~EEAUK~~ parent financial holding company or ~~EEAUK~~ parent mixed financial holding company responsibility for approval of all material aspects of rating and estimation processes.

5.2 The PRA expects an appropriate individual in a ~~Significant Influence Function (SIF)~~ Senior Management Function (SMF) role to provide to the PRA on an annual basis written attestation that:

(i) the firm's internal approaches for which it has received a permission comply with the CRR requirements and any applicable PRA IRB supervisory statements; and

(ii) where a model rating system has been found not to be compliant, a credible plan for a return to compliance is in place and being completed.

5.3 Firms should agree with the PRA the appropriate ~~SIF~~ SMF for providing this attestation.

The PRA would not expect to agree more than two ~~SIFs~~ SMFs to cover all the firm's IRB models. In agreeing which ~~SIF~~ SMF(s) may provide the annual attestation, the PRA will consider the firm's arrangements for approving rating and estimation processes under CRR Article 189.

(CRR Article 189, 20(6) and ~~CRD Article 3(1)(7)~~ 4(1)(9))

6 Permanent partial use

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Non-significant business units and immaterial exposure classes and types

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6.6 The following points set out the level at which the PRA would expect the 15% test to be applied for firms that are members of a group:

(a) if a firm were part of a group subject to consolidated supervision in the ~~EEA~~UK and for which the PRA was the lead regulator, the calculations in part (a) would be carried out with respect to the wider group;

(b) if a firm were part of a group subject to consolidated supervision in the ~~EEA~~UK and for which the PRA was not the lead regulator the calculation set out in part (a) would not apply but the requirements of the lead regulator related to materiality would need to be met in respect of the wider group;

(c) if the firm were part of a subgroup subject to consolidated supervision in the ~~EEA~~UK, and part of a wider ~~third-country~~non-UK group subject to equivalent supervision by a regulatory authority outside of the ~~EEA~~UK, the calculation set out in part (a) would not apply but the requirements of the lead regulator related to materiality would need to be met in respect of both the subgroup and the wider group; and

(d) if the firm is part of a subgroup subject to consolidated supervision in the ~~EEA~~UK, and is part of a wider ~~third-country~~non-UK group that is not subject to equivalent supervision by a regulatory authority outside of the EEA, then the calculation in part (a) would apply in respect of the wider group if supervision by analogy (as referred to in CRR) is applied and in respect of the subgroup if other alternative supervisory techniques are applied.

6.7 Whether a ~~third-country~~non-UK group is subject to equivalent supervision, whether it is subject to supervision by analogy, as referred to in the CRR, or whether other alternative supervisory techniques apply, is decided in accordance with ~~CRD Article 126~~Regulation 21 of The Capital Requirements Regulations 2013 (as amended by The Capital Requirements (Amendment) (EU Exit) Regulations 2018).

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11 Definition of default

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Application of materiality thresholds to banking groups with cross-border entities

11.6A Rule 6.1 of the Credit Risk Part of the PRA Rulebook requires a firm to apply the PRA's materiality thresholds to all of its exposures on a UK individual solo level and, if applicable, UK consolidation group level. When applying materiality thresholds at a solo level, overseas subsidiaries of UK firms are expected to apply the relevant local thresholds. However, the PRA expects firms to apply for a rule modification⁵ to modify rule 6.1 in order to also apply local thresholds for these overseas subsidiaries at the UK consolidation group level where, taking into account the local market characteristics, economic conditions, and financial risk, it would be more appropriate to apply the local thresholds than the PRA's thresholds.^[6] In respect of certain jurisdictions, the PRA may make available a 'modification by consent' and, if so, would provide details of the modification on the PRA's website. The PRA expects that firms apply for the modification for all jurisdictions in which the local thresholds are more appropriate, and not only those jurisdictions for which they expect the use

of local thresholds to reduce capital requirements. Firms should provide supporting information about the appropriateness of local thresholds for all waiver applications.

[6] This also applies to a scenario where UK firms ~~passport into~~operate in other jurisdictions, such that it is a UK firm with an exposures in a different jurisdiction.

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12 Probability of default in IRB approaches

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Supervisory slotting criteria for specialised lending

12.36 The PRA expects firms to assign exposures to the risk-weight category for specialised lending exposures based on the criteria set out in the tables in Appendix A. ~~The planned EBA regulatory technical standards on supervisory slotting will further specify these assignments.~~

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13 Loss given default in IRB approaches

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Downturn LGD

13.7A ~~As required by the UK Technical Standards on the specification of the nature, severity and duration of an economic downturn²¹, firms that identify an economic downturn must examine economic indicators over a historical time-span that provides values that are representative of the likely range of variability in the future, and that this period must have a duration of at least 20 years. The PRA expects that firms should select a historical time-span which enables the identification of economic indicator values that are sufficiently severe to represent downturn conditions. When identifying an economic downturn, the EBA Final Draft Regulatory Technical Standard on the specification of the nature, severity and duration of an economic downturn (EBA/RTS/2018/04)⁸ requires that firms examine economic indicators over the previous twenty years. In accordance with the RTS, the PRA expects firms to consider a period longer than twenty years where the values of the economic indicators are considered insufficiently severe during this period.~~

~~⁸This paragraph will only apply once the final RTS has entered into force and applies in the UK. References to the draft RTS should then be read as references to the final RTS published in the Official Journal of the European Union, and, after the end of the transition period, is subject to any amendments made to the RTS under the EU (Withdrawal) Act 2018.~~

²¹ As implemented by the Technical Standards (Economic Downturn) Instrument 2021.