

Credit risk mitigation (CRR) part

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Near Final Draft

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1. Application and definitions

1.1 This Part applies to JIBs.

1.2 In this Part, the following definitions shall apply:

Capital Market-Driven Transaction

means a transaction giving rise to an exposure secured by collateral which confers on the JIB the right to receive margin at least daily.

Master Netting Agreement

means a contract of a type specified in Article 196 which meets the requirements in Article 206.

Other Funded Credit Protection

means the eligible collateral specified in Article 200.

Other Funded Credit Protection Method

means calculating risk-weighted exposure amounts and, where applicable, expected loss amounts in accordance with the method set out in Article 232.

Secured Lending Transaction

means any transaction giving rise to an exposure secured by collateral which does not include a provision conferring upon the JIB the right to receive margin at least daily.

Underlying CIU

means a CIU in the shares or units of which another CIU has invested.

2 Level of application

A JIB must comply with this Part on the basis of its consolidated position, unless the JFSC has agreed a variance in accordance with the Risk-Based Capital Requirements Part.

3 Credit Risk Mitigation (Chapter 4 of Title II of Part Three of CRR)

Section 1 General requirements

Article 191A Use of credit risk mitigation techniques under the Standardised approach and the IRB approach

1. The provisions of this part apply only to the extent that a JIB takes into account credit risk mitigation techniques in the calculation of risk-weighted exposure amounts and, where applicable, expected loss amounts.
2. Where a JIB calculating risk-weighted exposure amounts and, where applicable, expected loss amounts, chooses to take into account credit risk mitigation, the JIB shall do so as follows:

- (a) [Note: Provision left blank]
- (b) where the JIB takes into account funded credit protection covering an exposure, the JIB shall take into account the funded credit protection in the calculation of the effect of credit risk mitigation for the purposes of calculating risk-weighted exposure amounts and, where applicable, expected loss amounts in accordance with the decision tree in Part 2 of Appendix 1;
- (c) subject to point (e), where the JIB takes into account unfunded credit protection covering an exposure, the JIB shall take into account the unfunded credit protection in the calculation of the effect of credit risk mitigation for the purposes of calculating risk weighted exposure amounts and, where applicable, expected loss amounts in accordance with the decision tree in Part 3 of Appendix 1;
- (d) without prejudice to paragraph 5 of Article 193, where the JIB takes into account both funded credit protection and unfunded credit protection covering the same exposure (other than the situation described in point (e)), the JIB shall take into account that credit protection in an appropriate manner that is consistent with the decision trees in Appendix 1, and in a way that does not double count the effects of the credit protection;
- (e) where a JIB has an exposure that is covered by unfunded credit protection that, in turn, is covered by funded credit protection and such JIB chooses to take into account either (i) only the funded credit protection or (ii) both the unfunded credit protection and the funded credit protection, then the JIB shall take into account the applicable credit protection or credit protections in an appropriate manner that is consistent with the decision tree in Part 4 of Appendix 1 (and, to the extent referenced therein, the decision trees in Parts 1 to 3 of Appendix 1), and in a way that does not double count the effects of the credit protection. Notwithstanding this point (e), such JIB may choose to take into account only the unfunded credit protection in accordance with point (c) and not the funded credit protection; and
- (f) to the extent a JIB chooses to take into account funded credit protection under point (e), references to the 'borrower' or the 'obligor' in this Part (in the context of unfunded credit protection which is covered by funded credit protection) shall be deemed to refer to either:
 - (i) only the provider of the unfunded protection;
 - (ii) one of the borrower/obligor or the provider of the unfunded credit protection; or
 - (iii) both the obligor and the provider of the unfunded credit protection,in each case where appropriate from a prudential point of view to reflect the nature of the credit protection arrangement and the risks related to that arrangement.

3. Where a JIB has a choice of methods available under this Part for taking into account unfunded credit protection, the JIB shall use the same method when taking into account the same type of unfunded credit protection. A JIB shall have in place documented policies specifying which method it shall use to take into account each type of unfunded credit protection.
4. Notwithstanding any other provision in this Part specifying the applicability of any of Articles 192 to 239, any such article shall apply to a JIB using the LGD Modelling Collateral Method or the LGD Adjustment Method, or to a JIB taking into account funded credit protection covering an exposure arising from a derivative instrument, or to a JIB applying the methods set in the Counterparty Credit Risk (CRR) Part to a settlement transaction, in each case solely to the extent provisions elsewhere in the Rulebook or CRR cross-refer to such article. Absent such cross-reference, such articles shall not

apply to institutions using any such method or institutions taking into account such funded credit protection covering any such exposure.

Article 192 Definitions

1. [Note: Provision left blank]
2. For the purposes of this Part, references to Institutions as issuers or as eligible credit providers shall also include undertakings established in third countries which would fall within the definition of Institutions if they were established in the UK.

Article 193 Principles for recognising the effect of credit risk mitigation techniques

A1. This Article applies to a JIBs taking into account credit risk mitigation using on-balance sheet netting, the Financial Collateral Comprehensive Method, the Financial Collateral Simple Method, the Other Funded Credit Protection Method, the Foundation Collateral Method, the Risk-Weight Substitution Method or the Parameter Substitution Method.

1. [Note: Provision left blank]
2. A JIB shall not double count the effect of credit risk mitigation. Where the risk-weighted exposure amount already takes account of credit protection under the Credit Risk: Standardised Approach (CRR) Part, Chapter 2 of Title II of Part Three of CRR or the Credit Risk: Internal Ratings Based Approach (CRR) Part a JIB shall not take into account that credit protection in the calculations under this Part 2A. For the purpose of applying the methods set out in paragraph A1, a JIB may choose to disregard any item of credit protection.
- 2A. For the purpose of applying the methods set out in paragraph A1, a JIB may choose to disregard any item of credit protection.
3. Where the provisions in Sections 2 and 3 are met, a JIB may amend the calculation of risk-weighted exposure amounts under the Standardised Approach and the calculation of risk weighted exposure amounts and expected loss amounts under the IRB Approach in accordance with the provisions of Sections 4 and 5.
4. A JIB shall treat cash, securities, or commodities purchased, borrowed, or received under a securities financing transaction as collateral.
5. Where a JIB calculating risk-weighted exposure amounts under the Standardised Approach has more than one form of credit risk mitigation covering a single exposure (other than the situation described in point (e) of paragraph 2 of Article 191A, which shall be considered a single form of credit risk mitigation for the purposes of this paragraph) it shall do both of the following:
 - (a) subdivide the exposure into parts covered by each form of credit risk mitigation; and
 - (b) calculate the risk-weighted exposure amount for each part obtained in point (a) separately in accordance with the provisions of the Credit Risk: Standardised Approach (CRR) Part, Chapter 2 of Title II of Part Three of CRR and this Part.
6. Subject to the prior application of paragraph 5, if applicable, if a JIB calculating risk weighted exposure amounts under the Standardised Approach covers a single exposure with multiple items of credit

protection of the same form and provided by a single protection provider and these items of protection have differing maturities (other than the situation described in point (e) of paragraph 2 of Article 191A, which shall be considered a single form of credit protection for the purposes of this paragraph), it shall do both of the following:

- (a) subdivide the exposure into parts, each of which are covered by credit protection with a single maturity; and
- (b) calculate the risk-weighted exposure amount for each part obtained in point (a) separately in accordance with the provisions of the Credit Risk: Standardised Approach (CRR) Part, Chapter 2 of Title II of Part Three of CRR and this Part.

7. Where a JIB has an item of eligible collateral covering multiple exposures the JIB shall:

- (a) subdivide the eligible collateral into one or more portions;
- (b) allocate each portion of eligible collateral to one of the exposures it covers, without any double-counting; and
- (c) calculate the effect of each portion of eligible collateral on the exposure to which it is allocated under point (b) separately in accordance with the provisions of this Part.

8.

- (a) Where a JIB has exposures associated with undrawn facilities, it may recognise collateral that satisfies all eligibility requirements set out in this Part.
- (b) Where drawing under a facility is conditional on the prior or simultaneous receipt of collateral by the JIB, to the extent of the JIB's interest in the collateral once the facility is drawn, notwithstanding that the JIB does not have any interest in the collateral to the extent the facility is undrawn, such collateral may be recognised for the exposures associated with the undrawn facility.

Article 194 Principles governing the eligibility of credit risk mitigation techniques

A1. This Article only applies to a JIB taking into account credit risk mitigation using on-balance sheet netting, the Financial Collateral Comprehensive Method, the Financial Collateral Simple Method, the Other Funded Credit Protection Method, the Foundation Collateral Method, the Risk-Weight Substitution Method or the Parameter Substitution Method.

- 1. A JIB shall conduct sufficient legal review to ensure that the technique used to provide the credit protection, together with the actions and steps taken and procedures and policies implemented by the JIB, shall be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions. It shall repeat such review as necessary to ensure continuing enforceability. The JIB shall be able to, upon request by the regulator, provide the most recent version of the independent, written and reasoned legal opinion that it used to establish whether its credit protection arrangements are legally effective and enforceable in all relevant jurisdictions.
- 2. A JIB shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address the risks related to that arrangement.

3. A JIB may only recognise funded credit protection in the calculation of the effect of credit risk mitigation where the assets relied upon for protection:
 - (a) are included in the list of eligible assets set out in Articles 197 to 200 or are eligible collateral pursuant to Counterparty Credit Risk (CRR) Part Articles 299 or 299A, as applicable; and
 - (b) are sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved, having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed.

4. A JIB may only recognise funded credit protection in the calculation of the effect of credit risk mitigation where the JIB has the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy or other credit event set out in the transaction documentation of the obligor and, where applicable, of the custodian holding the collateral. A JIB shall ensure that there is no material positive correlation between the value of the assets relied upon for protection and the credit quality of the obligor.

5. [Note: Provision left blank]

6. A JIB may take into account unfunded credit protection only where:
 - (a) the protection agreement is included in the list of eligible protection agreements set out in Article 203 and paragraph 1 (subject to paragraphs 2 and 3) of Article 204;
 - (b) the protection agreement is legally effective and enforceable in the relevant jurisdictions to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed; and
 - (c) the protection provider is of a kind that is included in the list of eligible protection providers set out in Article 201.

7. A JIB may take into account credit protection only where that credit protection complies with the applicable requirements set out in Section 3.

8. A JIB shall have adequate risk management processes to control those risks to which it may be exposed as a result of carrying out credit risk mitigation practices.

9. Notwithstanding the fact that credit risk mitigation has been taken into account for the purposes of calculating risk-weighted exposure amounts and, where applicable, expected loss amounts, a JIB shall continue to undertake and document a full credit risk assessment of the underlying exposure. In the case of securities financing transactions the underlying exposure shall, for the purposes of this paragraph only, be deemed to be the net amount of the exposure.

10. [Note: Provision left blank].

Section 2 Eligible forms of credit risk mitigation

Sub-Section 1 Funded credit protection

Article 195 On-Balance Sheet Netting

1. A JIB may use on-balance sheet netting of mutual claims between itself and its counterparty as an eligible form of credit risk mitigation.
2. Without prejudice to Article 196, a JIB using on-balance sheet netting may only take into account reciprocal cash balances between the JIB and the counterparty.

A JIB using on-balance sheet netting may only reflect loans to, and deposits received by, the JIB that are subject to an on-balance sheet netting agreement.

Article 196 Master netting agreements covering securities financing transactions

1. A JIB using the Financial collateral comprehensive method or the SFT VaR method may take into account the effects of bilateral netting contracts covering securities financing transactions.

Article 197 Eligibility of collateral under the financial collateral simple method, the financial collateral comprehensive method, the foundation collateral method and the SFT VaR method

1. A JIB using the Financial collateral simple method, the Financial collateral comprehensive method, the Foundation collateral method or the SFT VaR method may use the following items as eligible collateral:
 - (a) cash on deposit with, or cash assimilated instruments held by, the JIB;
 - (b) debt securities issued by central governments or central banks, where:
 - (i) the securities have a credit assessment by an ECAI recognised for risk weighting purposes under Credit Risk: Standardised approach (CRR) Part Article 135;
 - (ii) the securities do not have a credit assessment as set out in point (i) and a general issuer credit assessment of the relevant issuer by an ECAI recognised for risk weighting purposes under Credit Risk: Standardised approach (CRR) Part Articles 135 and 137 respectively is available;
 - (iii) the securities do not have a credit assessment as set out in point (i), a general issuer credit assessment as set out in point (ii) is not available, the security is issued by a central bank, and a general issuer credit assessment of the central government of the jurisdiction of the central bank by an ECAI recognised for risk weighting purposes under Credit Risk: Standardised approach (CRR) Part Articles 135 is available, or
 - (iv) the securities do not have a credit assessment as set out in point (i) and a credit assessment by an Export Credit Agency recognised for risk weighting purposes under Credit Risk: Standardised approach (CRR) Part Article 137 is available, and the available credit assessment in point (i), (ii), (iii) or (iv), as applicable, is associated with credit quality step 4 or above or with a minimum export insurance premium (MEIP) of 4 or better under the rules for the risk weighting of exposures to central governments or central banks under the Credit Risk: Standardised approach (CRR) Part and Chapter 2 of Title II of Part Three of *CRR*, and for this purpose where a credit assessment is available under both (iv) and either (ii) or (iii), the JIB may decide which credit assessment to refer to;

- (c) debt securities issued by:
 - (i) JIBs; or
 - (ii) Financial Institution exposures to which may be treated as exposures to JIBs under Credit Risk: Standardised approach (CRR) Part Article 119(5),
where the securities have a credit assessment by an ECAI which is associated with credit quality step 3 or above under the rules for the risk weighting of exposures to Institutions under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR;
 - (d) debt securities issued by other entities which securities have a credit assessment by an ECAI which is associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR;
 - (e) debt securities with a short-term credit assessment by an ECAI which is associated with credit quality step 3 or above under the rules for the risk weighting of short-term exposures under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR;
 - (f) equities or convertible bonds that are included in a main index;
 - (g) gold;
 - (h) securitisation positions that are not resecuritisation positions and which are subject to a 100% risk weight or lower in accordance with Securitisation (CRR) Part Articles 261 to 264.
2. For the purposes of point (b) of paragraph 1, 'debt securities issued by central governments or central banks' include:
- (a) debt securities issued by regional governments or local authorities, exposures to which are treated as exposures to the central government in whose jurisdiction they are established under paragraph 2 of Credit Risk: Standardised Approach (CRR) Part Article 115;
 - (b) [Note: Provision left blank]
 - (c) debt securities issued by multilateral development banks to which a 0% risk weight is assigned under paragraph 2 of Credit Risk: Standardised Approach (CRR) Part Article 117;(c) debt securities issued by international organisations which are assigned a 0% risk weight under Credit Risk: Standardised Approach (CRR) Part Article 118.
3. For the purposes of point (c) of paragraph 1, 'debt securities issued by Institutions include:
- (a) debt securities issued by regional governments or local authorities other than those debt securities referred to in point (a) of paragraph 2;
 - (b) debt securities issued by public sector entities, exposures to which are treated in accordance with paragraphs 1 and 2 of Credit Risk: Standardised Approach (CRR) Part Article 116 or are treated in

accordance with paragraphs 1 and 2 of Credit Risk: Standardised Approach (CRR) Part Article 116 under Article 116(5) of CRR;

(c) debt securities issued by multilateral development banks other than those to which a 0% risk weight is assigned under paragraph 2 of Credit Risk: Standardised Approach (CRR) Part Article 117.

4. A JIB using the Financial Collateral Simple Method, the Financial Collateral Comprehensive Method, or the Foundation Collateral Method may use as eligible collateral debt securities issued by other Institutions, or financial Institutions exposures to which may be treated as exposures to JIBs under Credit Risk: Standardised Approach (CRR) Part Article 119(5) where such debt securities do not have a credit assessment by an ECAI where:

- (a) the debt securities are listed on a recognised exchange;
- (b) the debt securities qualify as senior debt;
- (c) all rated issues by the issuing Institution of the same seniority have a credit assessment by an ECAI which is associated with credit quality step 3 or above under the rules for the risk weighting of exposures to Institutions or short term exposures under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR;
- (d) the JIB has no information to suggest that the issue would justify a credit assessment below that indicated in point (c); and
- (e) the market liquidity of the instrument is sufficient for these purposes.

5. A JIB using the Financial collateral simple method, the Financial collateral comprehensive method, the Foundation collateral method or the SFT VaR method may use as eligible collateral units or shares in CIUs where:

- (a) the units or shares have a daily public price quote;
- (b) the CIUs are limited to investing in instruments that are eligible for recognition under paragraphs 1 and 4; and
- (c) the CIUs meet the conditions laid down in paragraph 3 of Credit Risk: Standardised Approach (CRR) Part Article 132.

Where a CIU invests in shares or units of another CIU, the conditions laid down in points (a) to (c) of this paragraph shall apply to any such underlying CIU.

The use by a CIU of derivative instruments to hedge permitted investments shall not prevent units or shares in that CIU from being eligible as collateral.

6. For the purposes of paragraph 5, where a CIU ('the original CIU') or any of its underlying CIUs are not limited to investing in instruments that are eligible under paragraphs 1 and 4:

- (a) where the JIB would apply the look-through approach for a direct exposure to a CIU, as referred to in paragraph 1 of Credit Risk: Standardised Approach (CRR) Part Article 132A or paragraph 2 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 152, it may use units or shares in that CIU as collateral up to an amount (subject to the prior application of point (d)) equal to the value of the assets held by that CIU that are eligible under paragraphs 1 and 4, multiplied by the percentage of units or shares in that CIU pledged as collateral;
- (b) where the JIB would apply the mandate-based approach for a direct exposure to a CIU, as referred to in paragraph 2 of Credit Risk: Standardised Approach (CRR) Part Article 132A or paragraph 5 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 152, it may use units or shares in that CIU as collateral up to an amount (subject to the prior application of point (d)) equal to the value of the assets held by that CIU that are eligible under paragraphs 1 and 4 under the assumption that that CIU or any of its underlying CIUs have invested in non-eligible assets to the maximum extent allowed under their respective mandates, multiplied by the percentage of units or shares in that CIU pledged as collateral.

For the purpose of points (a) and (b) the JIB shall assume that the direct exposure is included in the non-trading book disregarding Trading Book (CRR) Part Article 104.

Where any Underlying CIU has Underlying CIUs of its own, a JIB may use units or shares in the original CIU as eligible collateral provided that it applies the appropriate methodology laid down in the first and second sub-paragraphs.

Where non-eligible assets held by the CIU may have a negative value due to liabilities or contingent liabilities resulting from ownership, a JIB shall:

- (c) calculate the total value of the non-eligible assets held by the CIU; and
 - (d) where the amount obtained under point (c) is negative, subtract the absolute value of that amount from the total value of the eligible assets held by the CIU.
7. With regard to points (b) to (e) of paragraph 1, where a security has two credit assessments by ECAs, a JIB shall apply the less favourable assessment. Where a security has more than two credit assessments by ECAs, the two most favourable credit assessments shall be referred to. If the two most favourable credit assessments are different, the JIB shall apply the less favourable of the two. If the two most favourable credit assessments are the same, the JIB shall apply either of those credit assessments.

8. [Note: Provision left blank]

9. [Note: Provision left blank]

Article 198 Additional eligibility of collateral under the financial collateral comprehensive method, and the foundation collateral method

1. [Note: Provision left blank]

2. [Note: Provision left blank]

Article 199 Additional eligibility for collateral under the foundation collateral method

1. In addition to the collateral referred to in Articles 197 and 198, a JIB that calculates risk-weighted exposure amounts and expected loss amounts under the Foundation collateral method may also use the following forms of collateral:
 - (a) immovable property collateral in accordance with paragraph 2;
 - (b) receivables in accordance with paragraph 5;
 - (c) other physical collateral in accordance with paragraph 6;
 - (d) leased property in accordance with paragraph 7.

2. The JIB may use as eligible collateral residential property which is, or will be, occupied or let by the owner, or the beneficial owner in the case of ownership by personal investment companies, and commercial immovable property, including offices and other commercial premises, where:
 - (a) the value of the property does not materially depend upon the credit quality of the obligor. (The JIB may exclude situations where purely macro-economic factors affect both the value of the property and the performance of the obligor from their determination of the materiality of such dependence); and
 - (b) in the case of commercial immovable property, the credit risk of the obligor does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the obligor to repay the debt from other sources and, as a consequence, repayment of the facility does not materially depend on any cash-flow generated by the underlying property serving as collateral.

3. [Note: Provision left blank]

4. [Note: Provision left blank]

5. The JIB may use as eligible collateral amounts receivable linked to a commercial transaction with an original maturity of less than or equal to one year where repayment will be funded by the commercial or financial flows related to the underlying assets of the counterparty, including:
 - (a) self-liquidating debt arising from the sale of goods or services linked to a commercial transaction; and
 - (b) amounts owed by buyers, suppliers, renters, national and local governmental authorities, or other non-affiliated parties not related to the sale of goods or services linked to a commercial transaction, but not including receivables associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.

6. The JIB may, if granted a variance by the JFSC, use as eligible collateral physical collateral of a type other than those indicated in paragraph 2 where the JIB is able to demonstrate to the JFSC that:
- (a) there are liquid markets, evidenced by frequent transactions taking into account the asset type, for the disposal of the collateral in an expeditious and economically efficient manner. The JIB shall carry out the assessment of this requirement periodically and where information indicates material changes in the market;
 - (b) there are well-established and publicly available market prices for the collateral. The JIB may consider market prices to be well-established where they come from reliable sources of information such as public indices and reflect the price of the transactions under normal conditions. The JIB may consider market prices to be publicly available where these prices are disclosed, easily accessible and obtainable regularly and without any undue administrative or financial burden;
 - (c) the JIB analyses the market prices, time and costs required to realise the collateral and the realised proceeds from the collateral;
 - (d) the JIB demonstrates that the realised proceeds from the collateral have not been below 70% of the collateral value in more than 10% of all liquidations for a given type of collateral; and
 - (e) where there is material volatility in the market prices of the collateral, the JIB is able to demonstrate that its valuation is sufficiently conservative.

The JIB shall comply with the requirements in points (a) to (e) of this paragraph on an ongoing basis and shall document how these requirements, and those specified in Article 210, are met.

7. Where the requirements set out in Article 211 are met, the JIB may treat exposures arising from transactions whereby the JIB leases property to a third party in the same manner as it would treat loans collateralised by the type of property leased.

8. [Note: Provision left blank]

Article 200 Other funded credit protection

1. A JIB may use the following Other funded credit protection as eligible collateral when using the Other funded credit protection method:
- (a) cash on deposit with, or cash assimilated instruments issued by the JIB and held by, a third party institution in a non-custodial arrangement and pledged to the JIB;
 - (b) life insurance policies pledged to the JIB;
 - (c) instruments issued by another Institution (or by Financial Institution exposures which may be treated as exposures to Institutions under Credit Risk: Standardised Approach (CRR) Part Article 119(5)), which instruments will be repurchased by that Institution or financial Institution on request.

Sub-Section 2 Unfunded credit protection

Article 201 Eligibility of protection providers under the risk-weight substitution method and the parameter substitution method

1. A JIB using the Risk-Weight Substitution Method or the Parameter Substitution Method may use the following parties as eligible providers of unfunded credit protection:

- (a) central governments or central banks;
- (b) regional governments or local authorities;
- (c) multilateral development banks;
- (d) international organisations exposures to which a 0% risk weight under Credit Risk: Standardised Approach (CRR) Part Article 118 is assigned;
- (e) public sector entities;
- (f) Institutions, (and Financial institution exposures to which may be treated as exposures to Institutions under Credit Risk: Standardised Approach (CRR) Part Article 119(5));
- (g) other corporate entities, including parent undertakings, subsidiaries and affiliated corporate entities of the obligor, where those other corporate entities have a credit assessment by an ECAI;
- (h) qualifying central counterparties.

2. In addition to the parties in paragraph 1, for an exposure where a JIB calculates risk-weighted exposure amounts and expected loss amounts using the Parameter substitution method, the JIB may use as eligible providers of unfunded credit protection other corporate entities that are internally rated by the JIB in accordance with the provisions of Credit Risk: Internal Ratings Based Approach (CRR) Part Articles 169 to 191.

Article 202

[Note: Provision left blank]

Article 203 Eligibility of guarantees as unfunded credit protection under the risk-weight substitution method and the parameter substitution method

1. A JIB using the Risk-Weight substitution method or the Parameter substitution method may use guarantees as eligible unfunded credit protection.

Article 204 Eligible types of credit derivatives under the risk-weight substitution method and the parameter substitution method

1. Subject to paragraph 3, a JIB using the Risk-Weight substitution method or the Parameter substitution method may use the following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are similar in their economic effect to such credit derivatives, as eligible credit protection:

- (a) credit default swaps;
- (b) total return swaps;
- (c) credit linked notes to the extent of their cash funding.

Where the institution buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record the offsetting deterioration in the value of the asset that is protected either through reductions in fair value or by an addition to reserves, the institution may not use that credit protection as eligible credit protection.

2. Where the JIB conducts an internal hedge using a credit derivative, the JIB may only use that credit derivative as eligible credit protection where the credit risk transferred to the trading book is transferred out to a third party.

Where an internal hedge has been conducted in accordance with the first sub-paragraph and the applicable requirements in this Part have been met, the JIB shall apply the rules set out in Sections 4 and 5 for the calculation of risk-weighted exposure amounts and expected loss amounts where it acquires unfunded credit protection.

3. The JIB may not use first-to-default and all other nth-to-default credit derivatives as eligible credit protection.

Section 3 Requirements

Sub-Section 1 Funded credit protection

Article 205 Requirements for on-balance sheet netting agreements other than master netting agreements referred to in article 206

1. If using On-balance sheet netting a JIB may use on-balance sheet netting agreements other than Master Netting Agreements referred to in Article 206 as an eligible form of credit risk mitigation where all the following conditions are met:
 - (a) those agreements are legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;
 - (b) the JIB is able to determine at any time the assets and liabilities that are subject to those agreements;
 - (c) the JIB monitors and controls the risks associated with the termination of the credit protection on an ongoing basis; and
 - (d) the JIB monitors and controls the relevant exposures on a net basis and does so on an ongoing basis.

Article 206 Requirements for master netting agreements covering securities financing transactions

1. A JIB using the Financial collateral comprehensive method may use Master Netting Agreement s covering securities financing transactions as an eligible form of credit risk mitigation where:
 - (a) they are legally effective and enforceable in all relevant jurisdictions, including in the event of the bankruptcy or insolvency of the counterparty;

- (b) they give the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon the event of default, including in the event of the bankruptcy or insolvency of the counterparty;
- (c) they provide for the netting of gains and losses on transactions closed out under an agreement so that a single net amount is owed by one party to the other; and
- (d) they allow for the prompt liquidation or set-off of collateral upon the event of default.

Article 207 Requirements for financial collateral under the Financial Collateral Simple Method, the Financial Collateral Comprehensive Method, and the Foundation Collateral Method

1. A JIB using the Financial Collateral Simple Method, the Financial Collateral Comprehensive Method, or the Foundation Collateral Method may use financial collateral and gold as eligible collateral where all the requirements laid down in paragraphs 2 to 4 are met.
2. The credit quality of the obligor and the value of the collateral shall not have a material positive correlation. Where the value of the collateral is reduced significantly, this shall not alone imply a significant deterioration of the credit quality of the obligor. Where the credit quality of the obligor deteriorates significantly, this shall not alone imply a significant reduction in the value of the collateral.

The JIB may not use securities issued by the obligor, or any related group entity, as eligible collateral. This notwithstanding, the JIB may use the obligor's own issues of Eligible Covered Bonds as eligible collateral when they are posted as collateral for a repurchase transaction, provided that they comply with the condition set out in the first sub-paragraph.

3. The JIB shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to their interest in the collateral. The JIB shall have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions. It shall re-conduct such review as necessary to ensure continuing enforceability.
4. The JIB shall fulfil all the following operational requirements:
 - (a) it shall properly document the collateral arrangements and have in place clear and robust procedures for the timely liquidation of collateral;
 - (b) it shall use robust procedures and processes to control risks arising from the use of collateral, including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, and concentration risk arising from the use of collateral and the interaction with the JIB's overall risk profile;
 - (c) it shall have in place documented policies and practices concerning the types and amounts of collateral accepted;
 - (d) it shall calculate the market value of the collateral, and revalue it accordingly, at least once every six months and whenever it has reason to believe that a significant decrease in the market value of the collateral has occurred;

- (e) where the collateral is held by a third party, it shall take reasonable steps to ensure that the third party segregates the collateral from its own assets;
 - (f) it shall ensure that it devotes sufficient resources to the orderly operation of margin agreements with OTC derivatives and securities financing counterparties, as measured by the timeliness and accuracy of its outgoing margin calls and response time to incoming margin calls; and
 - (g) it shall have in place collateral management policies to control, monitor, and report the following:
 - (i) the risks to which margin agreements expose it;
 - (ii) the concentration risk to particular types of collateral assets;
 - (iii) the reuse of collateral including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties;
 - (iv) the surrender of rights on collateral posted to counterparties.
5. In addition to meeting all the requirements set out in paragraphs 2 to 4, a JIB using the Financial Collateral Simple Method may use financial collateral as eligible collateral only where the residual maturity of the protection is at least as long as the residual maturity of the exposure.

Article 208 Requirements for immovable property collateral under the foundation collateral method

1. A JIB using the Foundation Collateral Method may use immovable property as eligible collateral only where all the requirements laid down in paragraphs 2 to 7 are met.
2. The following requirements on legal certainty shall be met:
 - (a) a mortgage or charge or other relevant security interest used is enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement and shall be properly filed on a timely basis;
 - (b) all legal requirements for establishing the pledge or other relevant security interest have been fulfilled;
 - (c) the protection agreement and the legal process underpinning it enable the JIB to realise the value of the protection within a reasonable timeframe.
3. The following requirements on monitoring of property values and on property valuation shall be met:
 - (a) the JIB monitors the value of the property on a frequent basis and at a minimum once every year for commercial immovable property and once every three years for residential property. The JIB carries out more frequent monitoring where the market is subject to significant changes in conditions;
 - (b) the JIB ensures the property valuation is reviewed and, if necessary, updated in the event that either:
 - (i) a default, as set out in Credit Risk: Internal Ratings Based Approach (CRR) Part Article 178, is considered to have occurred with regard to the obligor; or
 - (ii) information available to the JIB indicates that the value of the property may have declined materially relative to general market prices, and such review either is carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process or, where the property is valued by a statistical method in accordance with paragraph 1 of Article 229, comprises an assessment by

the JIB that the use of the statistical method remains suitably robust. For loans exceeding GBP 2.6 million or 5% of the own funds of a JIB, the property valuation shall be reviewed by such a valuer at least every three years.

The JIB may use statistical methods to monitor the value of the immovable property and to identify immovable property that needs revaluation.

4. The JIB shall clearly document the types of residential property and commercial immovable property it accepts and its lending policies in this regard.
5. The JIB shall have in place procedures to monitor that the immovable property taken as credit protection is adequately insured against the risk of damage.
6. The JIB shall monitor the extent of any permissible prior claims on the immovable property.
7. The JIB shall monitor the risk of environmental liability arising in respect of the immovable property.

Article 209 Requirements for receivables under the foundation collateral method

1. A JIB using the Foundation Collateral Method may use receivables as eligible collateral where all the requirements laid down in paragraphs 2 and 3 are met.
2. The following requirements on legal certainty shall be met:
 - (a) the legal mechanism by which the collateral is provided to the JIB shall be robust and effective and ensure that the JIB has clear rights over the collateral including the right to the proceeds from the sale of the collateral;
 - (b) the JIB shall take all steps necessary to fulfil requirements in all relevant jurisdictions in respect of the enforceability of its security interest. The JIB shall have a first priority claim over the collateral although such claims may still be subject to the claims of preferential creditors provided for in legislative provisions;
 - (c) the JIB shall have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions, and shall undertake such further review as is necessary to confirm continuing enforceability;
 - (d) the JIB shall properly document their collateral arrangements and shall have in place clear and robust procedures for the timely collection of collateral;
 - (e) the JIB shall have in place procedures that ensure that any legal conditions required for declaring the default of a borrower and timely collection of collateral are observed;

- (f) in the event of a borrower's financial distress or default, the JIB shall have legal authority to sell or assign the receivables to other parties without consent of the receivables' obligors.

3. The following requirements on risk management shall be met:

- (a) the JIB shall have in place a sound process for determining the credit risk associated with the receivables. Such a process shall include analyses of a borrower's business and industry and the types of customers with whom that borrower does business. Where the JIB relies on its borrowers to ascertain the credit risk of the customers, the JIB shall review the borrowers' credit practices to ascertain their soundness and credibility;
- (b) the difference between the amount of the exposure and the value of the receivables shall reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual borrower, and potential concentration risk within the JIB's total exposures beyond that controlled by the JIB's general methodology;
- (ba) the JIB shall maintain a continuous monitoring process appropriate for the specific exposures attributable to the receivables to be used as collateral. This process shall include, where appropriate and relevant, ageing reports, control of trade documents, borrowing base certificates, frequent audits of collateral, confirmation of accounts, control of the proceeds of accounts paid, analyses of dilution (credits given by the borrower to the issuers of the receivables), regular financial analysis of the borrower and, especially where a small number of large-sized receivables are to be used as collateral, the issuers of the receivables. The JIB shall monitor compliance with their overall concentration limits. It shall also review, on a regular basis, compliance with loan covenants, environmental restrictions, and other legal requirements;
- (c) receivables pledged by a borrower shall be diversified and not be unduly correlated with that borrower. Where there is material positive correlation, the JIB shall take into account the attendant risks in the setting of margins for the collateral pool as a whole;
- (d) the JIB shall not use receivables from affiliates of a borrower, including subsidiaries and employees, as eligible credit protection;
- (e) the JIB shall have in place a documented process for collecting receivable payments in distressed situations. The JIB shall have in place the requisite facilities for collection even when it normally relies on its borrowers for collections.

Article 210 Requirements for Other Physical Collateral under the Foundation Collateral Method

1. A JIB using the Foundation Collateral Method may use physical collateral other than immovable property collateral as eligible collateral where all the following conditions are met:
 - (a) the collateral arrangement under which the physical collateral is provided to the JIB shall be legally effective and enforceable in all relevant jurisdictions and shall enable the JIB to realise the value of the collateral within a reasonable timeframe;
 - (b) with the sole exception of claims of preferential creditors provided for in legislative provisions, the JIB shall have only first liens on, or charges over, such collateral and the JIB shall have priority over all other lenders to the realised proceeds of the collateral;

- (c) the JIB shall monitor the value of the collateral on a frequent basis and at least once every year.
The JIB shall carry out more frequent monitoring where the market is subject to significant changes in conditions;
 - (d) the transaction documentation shall include detailed descriptions of the collateral as well as detailed specifications of the manner and frequency of revaluation;
 - (e) the JIB shall clearly document in internal credit policies and procedures available for examination the types of physical collateral it accepts and the policies and practices it has in place in respect of the appropriate amount of each type of collateral relative to the exposure amount;
 - (f) the JIB's credit policies with regard to the transaction structure shall address the following:
 - (i) appropriate collateral requirements relative to the exposure amount;
 - (ii) the ability to liquidate the collateral readily;
 - (iii) the ability to establish objectively a price or market value;
 - (iv) the frequency with which the value can readily be obtained, including a professional appraisal or valuation;
 - (v) the volatility or a proxy of the volatility of the value of the collateral.
 - (g) when conducting valuation and revaluation, the JIB shall take fully into account any deterioration or obsolescence of the collateral, paying particular attention to the effects of the passage of time on fashion-sensitive or date-sensitive collateral;
 - (h) the JIB shall have the right to physically inspect the collateral. It shall also have in place policies and procedures addressing their exercise of the right to physical inspection, and, in the case of inventories, the periodic revaluation process shall include physical inspection;
 - (i) the collateral taken as protection shall be adequately insured against the risk of damage and the JIB shall have in place procedures to monitor this;
 - (j) the JIB shall monitor the extent of any permissible prior claims on the physical collateral; and
 - (k) the JIB shall monitor the risk of environmental liability arising in respect of the physical collateral.
2. Where a general security agreement, or other form of floating charge, provides a JIB using the Foundation Collateral Method with a registered claim over a company's assets, the JIB may recognise as eligible funded credit protection the assets that meet the requirements to qualify as eligible collateral under Articles 207 to 211. Where that claim is over both assets that meet such requirements and assets that do not meet such requirements, the JIB may recognise only the former as eligible funded credit protection.

Article 211 Requirements for treating lease exposures as collateralised under the Foundation collateral method

1. A JIB using the Foundation Collateral Method shall treat exposures arising from leasing transactions as collateralised by the type of property leased, where all the following conditions are met:
- (a) the conditions set out in Article 208 or 210, as applicable, for the type of property leased to qualify as eligible collateral are met;

- (b) the lessor has in place robust risk management with respect to the use to which the leased asset is put, its location, its age and the planned duration of its use, including appropriate monitoring of the value of the security;
- (c) the lessor has legal ownership of the asset and is able to exercise its rights as owner in a timely fashion; and
- (d) the difference between the value of the unamortised amount and the market value of the security is not so large as to overstate the credit risk mitigation attributed to the leased assets.

Article 212 Requirements for other funded credit protection

1. A JIB using the Other Funded Credit Protection Method may treat cash on deposit with, or cash assimilated instruments issued by the JIB and held by, a third-party institution in accordance with paragraph 1 of Article 232, where all the following conditions are met:
 - (a) the borrower's claim against the third-party institution is openly pledged or assigned to the JIB and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions and is unconditional and irrevocable;
 - (b) the third-party institution is notified of the pledge or assignment; and
 - (c) as a result of the notification, the third-party institution is able to make payments solely to the JIB or to other parties only with the JIB's prior consent.
2. A JIB using the Other Funded Credit Protection Method may use life insurance policies pledged to the JIB as eligible collateral where all the following conditions are met:
 - (a) the life insurance policy is openly pledged or assigned to the JIB;
 - (b) the company providing the life insurance is notified of the pledge or assignment and, as a result of the notification, may not pay amounts payable under the contract without the prior consent of the JIB;
 - (c) the JIB has the right to cancel the policy and receive the surrender value in the event of the default of the borrower;
 - (d) the JIB is informed of any non-payments under the policy by the policy-holder;
 - (e) the credit protection is provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the JIB shall ensure that the amount deriving from the insurance contract serves the JIB as security until the end of the duration of the credit agreement;
 - (f) the pledge or assignment is legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement;
 - (g) the surrender value is declared by the company providing the life insurance and is non-reducible;
 - (h) the surrender value is to be paid by the company providing the life insurance in a timely manner upon request;
 - (i) the surrender value shall not be requested without the prior consent of the JIB; and

- (j) the company providing the life insurance is an insurance undertaking or reinsurance undertaking or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the UK.

Sub-Section 2 Unfunded credit protection and credit linked notes

Article 213 Requirements common to guarantees and credit derivatives under the risk-weight substitution method and the parameter substitution method

1. Subject to paragraph 1 of Article 214, a JIB using the Risk-Weight Substitution Method or the Parameter Substitution Method may use credit protection deriving from a guarantee or credit derivative as eligible unfunded credit protection where all the following conditions are met:
 - (a) the credit protection is direct;
 - (b) the extent of the credit protection is clearly defined and incontrovertible;
 - (c) the credit protection contract does not contain any clause, the fulfilment of which is outside the direct control of the JIB, that:
 - (i) would allow the protection provider to unilaterally cancel or change the protection in a way that would adversely impact the JIB;
 - (ii) would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure;
 - (iii) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due, or when the leasing contract has expired for the purposes of recognising guaranteed residual value under paragraph 7 of Credit Risk: Standardised Approach (CRR) Part Article 134 and paragraph 4 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 166A;
 - (iv) could allow the maturity of the credit protection to be reduced by the protection provider;
 - (d) the credit protection contract is legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

For the purposes of point (c)(iii) of paragraph 1, a clause in the credit protection contract providing that the protection provider may pay all monies due in a timely manner and assume the future payment obligations of the obligor covered by the credit protection contract shall not disqualify that credit protection from being eligible.

2. The JIB shall be able to demonstrate that it has in place systems to manage potential concentration of risk arising from its use of guarantees and credit derivatives.
 - 2A. The JIB shall be able to demonstrate how its strategy in respect of its use of credit derivatives and guarantees interacts with its management of its overall risk profile.
3. The JIB shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of its unfunded credit protection under the law applicable to its interest in the

credit protection. The JIB shall have conducted sufficient legal review confirming the enforceability of the unfunded credit protection in all relevant jurisdictions. It shall repeat such review as necessary to ensure continuing enforceability.

Article 214 Sovereign counter guarantees under the risk-weight substitution method and the parameter substitution method

1. A JIB using the Risk-Weight Substitution Method or the Parameter Substitution Method may treat the exposures referred to in paragraph 2 as protected by a guarantee provided by the entities listed in that paragraph, provided that all the following conditions are satisfied:
 - (a) the counter-guarantee covers all credit risk elements of the exposure;
 - (b) both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in Article 213 and paragraph 1 of Article 215, except that the counter-guarantee need not be direct; and
 - (c) the cover is robust and there is no historical evidence that suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct guarantee by the entity in question.
2. The treatment set out in paragraph 1 shall apply to exposures protected by a guarantee which is counter-guaranteed by a central government or a central bank.
3. The JIB may apply the treatment set out in paragraph 1 also to an exposure which is not counter-guaranteed by an entity listed in paragraph 2 where that exposure's counter-guarantee is in turn directly guaranteed by one of those entities and the conditions listed in paragraph 1 are also satisfied in respect of that guarantee of the counter-guarantee.

Article 215 Additional requirements for guarantees under the risk-weight substitution method and the parameter substitution method

1. A JIB using the Risk-Weight Substitution Method or the Parameter Substitution Method may use guarantees as eligible unfunded credit protection where all the conditions in Article 213 and all the following conditions are met:
 - (a) on the qualifying default of or non-payment by the obligor, the JIB has the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided.

In the case of unfunded credit protection covering residential mortgage loans, the requirements in point (c)(iii) of paragraph 1 of Article 213 and in the first paragraph of this point (a) may be satisfied within 24 months;

- (aa) payment by the guarantor to the JIB shall not be subject to the JIB first having to pursue the obligor;

- (b) the guarantee is an explicitly documented obligation assumed by the guarantor;
 - (c) either of the following conditions is met:
 - (i) the guarantee covers all types of payments the obligor is expected to make in respect of the claim;
 - (ii) where certain types of payment are excluded from the guarantee, the JIB has adjusted the value of the guarantee to reflect the limited coverage.
2. In the case of guarantees provided in the context of mutual guarantee schemes or provided by or counter-guaranteed by entities listed in paragraph 2 of Article 214, the requirements in points (a) and (aa) of paragraph 1 shall be considered to be satisfied where either of the following conditions is met:
- (a) on the qualifying default of or non-payment by the obligor, the JIB has the right to obtain in a timely manner a provisional payment by the guarantor that meets both the following conditions:
 - (i) it represents a robust estimate of the amount of the loss, including losses resulting from the non-payment of interest and other types of payment which the borrower is obliged to make, that the JIB is likely to incur;
 - (ii) it is proportional to the coverage of the guarantee;
 - (b) the JIB can demonstrate that the effects of the guarantee, which shall also cover losses resulting from the non-payment of interest and other types of payments which the borrower is obliged to make, justify such treatment.

Article 216 Additional requirements for credit derivatives under the risk-weight substitution method and the parameter substitution method

1. A JIB using the Risk-Weight Substitution Method or the Parameter Substitution Method may use credit derivatives as eligible unfunded credit protection where all the conditions in Article 213 and all the following conditions are met:
- (a) the credit events specified in the credit derivative contract include:
 - (i) the failure to pay the amounts due under the terms of the underlying obligation that are in effect at the time of such failure, with a grace period that is equal to or shorter than the grace period in the underlying obligation;
 - (ii) the bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events;
 - (iii) the restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event;
 - (b) where credit derivatives allow for cash settlement:
 - (i) the JIB has in place a robust valuation process in order to estimate loss reliably;
 - (ii) there is a clearly specified period for obtaining post-credit-event valuations of the underlying obligation;

- (c) where the protection buyer's right and ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation provide that any required consent to such transfer shall not be unreasonably withheld;
- (d) the identity of the parties responsible for determining whether a credit event has occurred is clearly defined;
- (e) the determination of the credit event is not the sole responsibility of the protection provider; and
- (f) the protection buyer has the right or ability to inform the protection provider of the occurrence of a credit event.

Where the credit events do not include restructuring of the underlying obligation as described in point (a)(iii), the JIB may nonetheless use such credit protection as eligible unfunded credit protection, which unfunded credit protection shall (unless paragraph 3 applies) be subject to a reduction in the value as specified in paragraph 2 of Article 233.

2. The JIB may use as eligible unfunded credit protection a credit derivative for which there is a mismatch between the underlying obligation and the reference obligation under the credit derivative, or between the underlying obligation and the obligation used for the purposes of determining whether a credit event has occurred, only where both the following conditions are met:
 - (a) the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, ranks *pari passu* with or is junior to the underlying obligation;
 - (b) the underlying obligation and the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, share the same obligor and legally enforceable cross-default or cross-acceleration clauses are in place.
3. By way of derogation from paragraph 1, for a corporate exposure covered by a credit derivative, the credit event referred to in point (a)(iii) of that paragraph shall not need to be specified in the derivative contract, provided that all of the following conditions are met:
 - (a) a 100% vote of all those affected is needed to amend the maturity, principal, coupon, currency or seniority status of the underlying corporate exposure; and
 - (b) the legal domicile in which the corporate exposure is governed has a well-established bankruptcy code that allows for a company to reorganise and restructure, and provides for an orderly settlement of creditor claims.

Article 217

[Note: Provision left blank]

Section 4 Calculating the effects of credit risk mitigation

Sub-Section 1 Funded credit protection

Article 218 Credit linked notes

1. A JIB using the Financial Collateral Simple Method, the Financial Collateral Comprehensive Method or the Foundation Collateral Method may treat investments in credit linked notes issued by the JIB as cash collateral for the purpose of calculating the effect of funded credit protection in accordance with Sub-section 1 of Section 4, provided that the credit default swap embedded in the credit linked note qualifies as eligible unfunded credit protection under this Part. For the purpose of determining whether the credit default swap embedded in a credit linked note qualifies as eligible unfunded credit protection, the JIB may consider the condition in point (c) of paragraph 6 of Article 194 to be met.

Article 219 On-Balance Sheet Netting

1. Where a JIB has loans and deposits subject to an eligible on-balance sheet netting agreement, the JIB may calculate the exposure value as the greater of:

- (a) zero; and
- (b) the amount in point (ii) subtracted from the amount in point (i):
- (c) the value of the exposure calculated in accordance with paragraph 1 of Credit Risk:

Standardised Approach (CRR) Part Article 111 or paragraph 2 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 166A, as applicable, to the counterparty subject to the on-balance sheet netting agreement; total value of loans to and deposits with the JIB subject to the on-balance sheet netting agreement, adjusted for any currency and maturity mismatches between the exposure in point (i) and the loans and deposits in this point (ii) in accordance with paragraphs 2 and 3.

2. Where there is a currency mismatch between the exposure referred to in point (b)(i) of paragraph 1 and the loans and deposits referred to in point (b)(ii) of paragraph 1, the JIB shall reflect the mismatch by applying the appropriate volatility adjustment specified in Table 4 in paragraph 1 of Article 224 to the value of the protection. The JIB shall apply a 10 business day liquidation period. Where marking to market is not conducted daily, the JIB shall scale up the volatility adjustment using the formula in paragraph 1 of Article 226.
3. Where there is a maturity mismatch as determined by Articles 237 or 238, the JIB shall reflect the mismatch in accordance with paragraph 2 of Article 239. References to collateral in paragraph 2 of Article 239 shall be read as references to the loans to and deposits with the JIB subject to the eligible on-balance sheet netting agreement for the purposes of this Article.
4. Subject to paragraph 1 of Article 228, a JIB shall use the exposure value as calculated under paragraph 1 as the exposure value of the exposure to the counterparty arising from the loans and deposits subject to the eligible on-balance sheet netting agreement for the purposes of Credit Risk:

Standardised Approach (CRR) Part Article 113 or the Credit Risk: Internal Ratings Based Approach (CRR) Part.

Article 220 Using the financial collateral comprehensive method for master netting agreements

1. A JIB using the Financial Collateral Comprehensive Method shall, when calculating the 'fully adjusted exposure value' (E^*) for the exposures subject to an eligible Master Netting Agreement covering securities financing transactions, calculate the volatility adjustments in accordance with that method.
2. For the purpose of calculating E^* , the JIB shall:
 - (a) calculate the net position in each group of securities or in each type of commodity by subtracting the amount in point (ii) from the amount in point (i):
 - (i) the total value of a group of securities or of commodities of the same type lent, sold or provided under the Master Netting Agreement or the amount of cash lent or transferred under that Master Netting Agreement;
 - (ii) the total value of a group of securities or of commodities of the same type borrowed, purchased or received under the Master Netting Agreement or the amount of cash borrowed or received under that Master Netting Agreement;
 - (b) calculate the net position in each currency, other than the settlement currency of the Master Netting Agreement, by subtracting the amount in point (ii) from the amount in point (i):
 - (i) the sum of the total value of groups of securities and types of commodities denominated in that currency lent, sold or provided under the Master Netting Agreement and the amount of cash in that currency lent or transferred under that Master Netting Agreement;
 - (ii) the sum of the total value of groups of securities and types of commodities denominated in that currency borrowed, purchased or received under the Master Netting Agreement and the amount of cash in that currency borrowed or received under that Master Netting Agreement.

These calculations pursuant to points (i) and (ii) shall exclude groups of securities and commodities where:

(1) the net position calculated in point (a) of paragraph 2 is negative; and

(2) the securities and commodities either:

(A) are not included in the lists of eligible collateral set out in Articles 197 and 198 and are not eligible collateral pursuant to Counterparty Credit Risk (CRR) Part Articles 299 or 299A; or

(B) do not meet the requirements laid down in paragraphs 2 to 4 of Article 207.

3. The JIB shall calculate E^* in accordance with the following formula:

$$E^* = \max \left\{ 0, \sum_m E_m + 0.4 \cdot E_{net} + 0.6 \cdot \left(\frac{E_{gross}}{\sqrt{N}} \right) + \sum_k |E_k^{fx}| \cdot H_k^{fx} \right\}$$

where:

- m = the index that denotes all groups of securities, types of commodities, or cash positions under the Master Netting Agreement. This index shall exclude groups of securities and types of commodities where:
 - (a) the net position calculated in point (a) of paragraph 2 is negative; and
 - (b) the securities or commodities either:
 - (i) are not included in the lists of eligible collateral set out in Articles 197 and 198 and are not eligible collateral pursuant to Counterparty Credit Risk (CRR) Part Articles 299 or 299A; or
 - (ii) do not meet the requirements laid down in paragraphs 2 to 4 of Article 207;
- E_m = the net position in each group of securities, type of commodities, or cash position under the Master Netting Agreement. This shall have a positive sign where the net position as calculated in point (a) of paragraph 2 is positive, and a negative sign where the net position as calculated in point (a) of paragraph 2 is negative.
- k = the index that denotes all separate currencies in which any securities, commodities or cash positions under the Master Netting Agreement are denominated.
- E_k^{fx} = the net position (positive or negative) in a given currency k other than the settlement currency of the Master Netting Agreement as calculated under point (b) of paragraph 2;
- H_k^{fx} = the foreign exchange volatility adjustment for currency k , which shall always be expressed as a positive value;
- E_{net} = the net exposure of the Master Netting Agreement, calculated as follows:

$$E_{net} = \left| \sum_m E_m \cdot H_m \right|$$

where:

- H_m = the volatility adjustment appropriate to each group of securities, type of commodities, or cash position m , which shall always be expressed as a positive value (or zero, as applicable);
- N = the total number of distinct groups of the same securities and distinct types of the same commodities under the Master Netting Agreement ; for the purposes of this calculation, those groups and types E_m for which $|E_m| < 1/10 \cdot \max_m(|E_m|)$ shall not be counted. This index shall exclude groups of securities and types of commodities where:
 - (a) the net position calculated in point (a) of paragraph 2 is negative; and
 - (b) the securities or commodities either:
 - (i) are not included in the lists of eligible collateral set out in Articles 197 and 198 and are not eligible collateral pursuant to Counterparty Credit Risk (CRR) Part Articles 299 or 299A; or
 - (ii) do not meet the requirements laid down in paragraphs 2 to 4 of Article 207;
- E_{gross} = the gross exposure of the Master Netting Agreement, calculated as follows:

$$E_{gross} = \sum_m |E_m| \cdot H_m$$

4. For the purpose of calculating risk-weighted exposure amounts and, where applicable, expected loss amounts for securities financing transactions covered by Master Netting Agreements, a JIB using the Financial Collateral Comprehensive Method shall use E^* as calculated under paragraph 3 as the exposure value of the exposure to the counterparty arising from the transactions subject to the Master Netting Agreement for the purposes of Credit Risk: Standardised Approach (CRR) Part Article 113 or Credit Risk: Internal Ratings Based Approach (CRR) Part Article 166B.

5. For the purposes of paragraphs 2 and 3, 'group of securities' means securities which are issued by the same entity, have the same issue date, have the same maturity, are subject to the same terms and conditions, are denominated in the same currency, and are subject to the same liquidation periods as indicated in Article 224.

Article 221 Using the SFT VaR method

[Note: Provision left blank]

Article 222 Financial collateral simple method

1. A JIB may use the Financial Collateral Simple Method only where it calculates risk-weighted exposure amounts under the Standardised Approach (including in relation to exposures for which the JIB may use the Standardised Approach instead of the IRB Approach under the Credit Risk: Internal Ratings Based Approach (CRR) Part).

A JIB that chooses to use the Financial Collateral Simple Method in respect of exposures for which it calculates risk-weighted exposure amounts using the Standardised Approach shall not use the Financial Collateral Comprehensive Method in respect of any such exposures.

2. The JIB shall assign to eligible financial collateral a value equal to its market value as determined in accordance with point (d) of paragraph 4 of Article 207.
3. The JIB shall assign a risk weight to those portions of exposure values that are collateralised by the market value of eligible collateral, being the risk weight that it would assign under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR where the JIB had a direct exposure to the collateral instrument.

The risk weight of the collateralised portion shall be at least 20% except as specified in paragraphs 4 to 6. The JIB shall apply to the remainder of the exposure value the risk weight that it would assign to an unsecured exposure to the counterparty under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR.

- 3A. For the purposes of paragraph 3, the JIB shall:

(a) for an on-balance sheet exposure:

- (i) where Article 219 applies, use the exposure value calculated in accordance with that Article;
- (ii) where Article 219 does not apply, use the exposure value calculated in accordance with paragraph 1 of Credit Risk: Standardised Approach (CRR) Part Article 111; and

(b) for an off-balance sheet item, use an exposure value equal to 100% of the item's value.

4. The JIB shall assign a risk weight of 0% to the collateralised portion of the exposure arising from securities financing transactions which fulfil the criteria in Article 227. Where the counterparty to the transaction is not a core market participant, the JIB shall assign a risk weight of 10%.
5. [Note: Provision left blank]
6. For transactions other than those referred to in paragraph 4, the JIB may assign a 0% risk weight where the exposure and the collateral are denominated in the same currency, and either of the following conditions is met:
 - (a) the collateral is cash on deposit or a cash assimilated instrument issued by the JIB;
 - (b) the collateral is in the form of debt securities issued by central governments or central banks eligible for a 0% risk weight under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR, and its market value has been discounted by 20%.
7. For the purposes of paragraph 6 debt securities issued by central governments or central banks shall include:
 - (a) debt securities issued by regional governments or local authorities, exposures to which are treated as exposures to the central government in whose jurisdiction they are established under paragraph 2 of Credit Risk: Standardised Approach (CRR) Part Article 115;
 - (b) debt securities issued by multilateral development banks to which a 0% risk weight is assigned under or by virtue of paragraph 2 of Credit Risk: Standardised Approach (CRR) Part Article 117;
 - (c) debt securities issued by international organisations which are assigned a 0% risk weight under Credit Risk: Standardised Approach (CRR) Part Article 118.
 - (d) [Note: Provision left blank]

Article 223 Financial collateral comprehensive method

A1. This Article applies to a JIB using the Financial Collateral Comprehensive Method.

1. In order to take account of price volatility, a JIB shall apply volatility adjustments to the market value of collateral, as set out in Articles 224, 226, and 227, when valuing financial collateral.

Where collateral is denominated in a currency that differs from the currency in which the underlying exposure is denominated, the JIB shall add an adjustment reflecting currency volatility to the volatility adjustment appropriate to the collateral as set out in Articles 224, 226, and 227.

In the case of OTC derivatives transactions covered by netting agreements that meet the requirements set out in Section 7 of Chapter 3 of the Counterparty Credit Risk (CRR) Part, the JIB shall apply a volatility adjustment reflecting currency volatility when there is a mismatch between the collateral currency and the

settlement currency. Where multiple currencies are involved in the transactions covered by the netting agreement, the JIB shall apply a single volatility adjustment.

2. The JIB shall calculate the volatility-adjusted value of the collateral (CVA) it recognises as follows:

$$CVA = C \cdot (1 - H_C - H_{fx})$$

where:

C = the value of the collateral;

HC = the volatility adjustment appropriate to the collateral, as calculated under Articles 224, 226, and 227;

Hfx = the volatility adjustment appropriate to currency mismatch, as calculated under Articles 224, 226, and 227.

The JIB shall use the formula in this paragraph when calculating the volatility-adjusted value of the collateral for all transactions except for those transactions to which the provisions set out in Article 220 apply.

3. The JIB shall calculate the volatility-adjusted value of the exposure (EVA) they need to take into account as follows:

$$EVA = E \cdot (1 + H_E)$$

where:

E =

(d) where Article 219 applies, the exposure value calculated in accordance with that Article;

(c) where Article 219 does not apply, the exposure value as would be determined

under the Credit Risk: Standardised Approach (CRR) Part, Chapter 2 of Title II of Part Three of CRR or the Credit Risk: Internal Ratings Based Approach (CRR) Part as applicable, as if the exposure was not collateralised;

HE = the volatility adjustment appropriate to the exposure, as calculated under Articles 224, 226, and 227.

In the case of OTC derivative transactions, a JIB using the IMM shall calculate EVA as follows:

$$EVA = E$$

4. For the purpose of calculating E in paragraph 3 when Article 219 does not apply, the following shall apply:
 - (e) for exposures where the JIB calculates risk-weighted exposure amounts using the Standardised Approach, it shall calculate the exposure value in accordance with Credit Risk: Standardised Approach (CRR) Part Article 111, with the exception that for the purposes of this paragraph the exposure value of an off-balance sheet item shall be 100% of that item's value;
 - (d) for exposures where the JIB calculates risk-weighted exposure amounts using the IRB APPROACH, it shall calculate the exposure value in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Articles 166A to 166C, with the exception that for the purposes of this paragraph the exposure value of an off-balance sheet item shall be 100% of its value.
5. The JIB shall calculate the fully adjusted value of the exposure E^* , taking into account both volatility and the risk-mitigating effects of collateral as follows:

$$E^* = \max\{0, EVA - CVAM\}$$

where:

EVA = the volatility adjusted value of the exposure as calculated in paragraph 3;

CVAM = CVA further adjusted for any maturity mismatch in accordance with the provisions of Articles 237 to 239.

Subject to paragraph 5A, the JIB shall use the formula in this paragraph when calculating the fully adjusted value of the exposure for all transactions except for those transactions to which the provisions set out in Article 220 apply.

- 5A. For the purposes of the calculation under paragraph 5, in the case of OTC derivative transactions, a JIB using the methods laid down in Sections 3, 4 and 5 of Chapter 3 of the Counterparty Credit Risk (CRR) Part shall take into account the risk-mitigating effects of collateral in accordance with the provisions laid down in Sections 3, 4 and 5 of Chapter 3 of Counterparty Credit Risk (CRR) Part, as applicable.

6. [Note: Provision left blank]

7. Where the collateral consists of a number of eligible items, the JIB shall calculate the volatility adjustment (H) as follows:

$$H = \sum_i a_i H_i$$

where:

a_i = the proportion of the value of an eligible item i in the total value of such collateral;

H_i = the volatility adjustment applicable to eligible item i .

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Article 224 Supervisory volatility adjustment under the financial collateral comprehensive method

1. A JIB using the Financial Collateral Comprehensive Method shall, where there is daily revaluation, apply the volatility adjustments set out in Tables 1 to 4 of this paragraph.

Volatility adjustments

Table 1 — Rated debt securities and securitisation positions

| Credit quality step with which the credit assessment of the debt security is associated | Residual Maturity | Volatility adjustments for debt securities issued by entities described in point (b) of paragraph 1 of Article 197 | | | Volatility adjustments for debt securities issued by entities described in points (c) and (d) of paragraph 1 of Article 197 | | | Volatility adjustments for securitisation positions and meeting the criteria in point (h) of paragraph 1 of Article 197 | | |
|---|-------------------|--|-------------------------------|------------------------------|---|-------------------------------|-------|---|-------------------------------|------------------------------|
| | | 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) | 20-day liquidation period (%) | 10-day liquidation period (%) | | 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) |
| 1 | ≤ 1 year | 0.707 | 0.5 | 0.354 | 1.414 | 1 | 0.707 | 2.828 | 2 | 1.414 |
| | >1 ≤ 3 years | 2.828 | 2 | 1.414 | 4.243 | ~ | 2.121 | 11.314 | 8 | 5.657 |
| | >3 ≤ 5 years | 2.828 | 2 | 1.414 | 5.657 | 4 | 2.828 | 11.314 | 8 | 5.657 |
| | > 5 ≤ 10 years | 5.657 | 4 | 2.828 | | 6 | 4.243 | 22.627 | 16 | 11.314 |
| | > 10 years | 5.657 | 4 | 2.828 | 16.971 | 12 | 8.485 | 22.627 | 16 | 11.314 |
| 2-3 | ≤ 1 year | 1.414 | 1 | | 2.828 | 2 | 1.414 | 5.657 | 4 | 2.828 |

| | | | | | | | | | | |
|---|----------------|--------|----|--------|--------|-----|--------|--------|-----|--------|
| | >1 ≤ 3 years | 4.243 | 3 | 2.121 | 5.657 | 4 | 2.828 | 16.971 | 12 | 8.485 |
| | >3 ≤ 5 years | 4.243 | 3 | 2.121 | 8.485 | 6 | 4.243 | 16.971 | 12 | 8.485 |
| | > 5 ≤ 10 years | 8.485 | 6 | 4.243 | 16.971 | 12 | 8.485 | 33.941 | 24 | 16.971 |
| | > 10 years | 8.485 | 6 | 4.243 | 28.284 | 20 | 14.142 | 33.941 | 24 | 16.971 |
| 4 | all | 21.213 | 15 | 10.607 | N/A | N/A | N/A | N/A | N/A | N/A |

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Table 2 Debt securities and securitisation positions with a short-term credit assessment

| Credit quality step with which the credit assessment of a short-term debt security is associated | Volatility adjustments for debt securities issued by entities described in point (b) of paragraph 1 of Article 197 with short-term credit assessments | | | Volatility adjustments for debt securities issued by entities described in points (c) and (d) of paragraph 1 of Article 197 with short-term credit assessments | | | Volatility adjustments for securitisation positions and meeting the criteria in point (h) of paragraph 1 of Article 197 with short-term credit assessments | | |
|--|---|-------------------------------|------------------------------|--|-------------------------------|------------------------------|--|-------------------------------|------------------------------|
| | 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) | 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) | 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) |
| 1 | 0.707 | 0.5 | 0.354 | 1.414 | 1 | 0.707 | 2.828 | 2 | 1.414 |
| 2-3 | 1.414 | 1 | 0.707 | 2.828 | 2 | 1.414 | 5.657 | 4 | 2.828 |

Table 3 Other collateral or exposure types

| | 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) |
|---|-------------------------------|-------------------------------|-------------------------------|
| Main Index Equities, Main Index Convertible Bonds | 28.284 | | 14.142 |
| Other Equities or Convertible Bonds listed on a recognised exchange | 42.426 | 30 | 21.213 |
| Cash and cash assimilated instruments issued by the JIB | 0 | 0 | 0 |
| 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) | 20-day liquidation period (%) |

Table 4 Volatility adjustment for currency mismatch

| 20-day liquidation period (%) | 10-day liquidation period (%) | 5-day liquidation period (%) |
|-------------------------------|-------------------------------|------------------------------|
| 11.314 | 8 | 5.657 |

1. The calculation of volatility adjustments in accordance with paragraph 1 shall be subject to the following conditions:
 - (a) for secured lending transactions the liquidation period shall be 20 business days;
 - (b) for repurchase transactions, except insofar as such transactions involve the transfer of commodities or guaranteed rights relating to title to commodities, and securities lending or borrowing transactions, the liquidation period shall be five business days;
 - (c) for capital market-driven transactions for which no liquidation period is set out in point (b), the liquidation period shall be 10 business days.

Where a JIB has a transaction or netting set which meets the criteria set out in Article 285(2), (3) and (4) of CRR, the liquidation period shall be brought in line with the margin period of risk that would apply under those paragraphs. Where this results in a liquidation period for which volatility adjustments are not set out in paragraph 1, the JIB shall scale up or down, as applicable, the volatility adjustment for such liquidation period using the formula in paragraph 2 of Article 226.

2. In Tables 1 to 4 of paragraph 1 and, in paragraphs 4 to 6, the credit quality step with which a credit assessment of the debt security is associated is the credit quality step with which the credit assessment is associated under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR.

For the purpose of determining the credit quality step with which a credit assessment of the debt security is associated, as referred to in the first sub-paragraph, paragraph 7 of Article 197 also applies.

3. For non-eligible securities and commodities lent or sold under securities financing transactions, the JIB shall apply the same volatility adjustment as it would for equities which are not equities included in a main index but are listed on a recognised exchange.
4. For eligible units in CIUs:
 - (a) where the JIB would be able to apply the look-through approach to a direct exposure to the units under Credit Risk: Standardised Approach (CRR) Part Article 132A, the JIB shall apply the weighted average volatility adjustments that would apply, having regard to the liquidation period of the transaction as specified in paragraph 2, to the assets in which the fund has invested;
 - (b) in all other cases, the JIB shall apply the highest volatility adjustment that would apply to any of the assets in which the fund has the right to invest.
5. For unrated debt securities issued by JIBs (or financial institutions exposures to which may be treated as exposures to JIBs under Article 119(5) of CRR) and satisfying the eligibility criteria in paragraph 4 of Article 197, the JIB shall apply the same volatility adjustment as for securities issued by institutions or corporates with an external credit assessment associated with credit quality step 2 or 3.
6. For debt securities issued by central governments or central banks falling within points (b)(ii) or (iii) of paragraph 1 of Article 197, the JIB shall apply the volatility adjustment that would apply if the available general issuer credit assessment referred to in those points were a credit assessment of such debt security.

Article 226 Scaling Up of Volatility Adjustment under the Financial Collateral Comprehensive Method

1. A JIB using the Financial Collateral Comprehensive Method shall apply the volatility adjustments set out in Article 224 where there is daily revaluation. Where the frequency of revaluation is less than daily, the JIB shall apply larger volatility adjustments. The JIB shall calculate the larger volatility adjustments by scaling up the daily revaluation volatility adjustments, using the following square-root-of-time formula:

$$H = H_m \cdot \sqrt{\frac{N_R + (T_m - 1)}{T_m}}$$

where:

H = the volatility adjustment to be applied;

H_m = the volatility adjustment where there is daily revaluation; NR = the actual number of business days between revaluations; T_m = the liquidation period for the type of transaction in question.

2. A JIB using the Financial Collateral Comprehensive Method that has a transaction or netting set which meets the criteria set out in the second sub-paragraph of paragraph 2 of Article 224 may scale up or down the volatility adjustments set out in Article 224 to reflect the liquidation periods set out in the second sub-paragraph of paragraph 2 of Article 224 (instead of the liquidation periods set out in points (a), (b) or (c) of the first sub-paragraph of paragraph 2 of Article 224, as applicable), for the type of transaction in question, using the following square-root-of-time formula:

$$H_m = H_n \cdot \sqrt{\frac{T_m}{T_n}}$$

T_m = the liquidation period for the type of transaction in question;

T_n = the liquidation period that would apply to the transaction under points (a) to (c) of Article 224(2);

H_m = the volatility adjustment based on the liquidation period T_m;

H_n = the volatility adjustment based on the liquidation period T_n.

Article 227 Conditions for Applying a 0% Volatility Adjustment under the Financial Collateral Comprehensive Method

1. In relation to securities financing transactions, where a JIB uses the Financial Collateral Comprehensive Method and where the conditions set out in points (a) to (i) of paragraph 2 are satisfied, the JIB may, instead of applying the volatility adjustments calculated under Articles 224 and 226, apply a 0% volatility adjustment. A JIB using the SFT VaR Method shall not use the treatment set out in this Article.
2. The conditions referred to in paragraph 1 are:
 - (a) both the exposure and the collateral are cash or debt securities issued by central governments or central banks within the meaning of point (b) of paragraph 1 of Article 197 and eligible for a 0% risk weight under the Credit Risk: Standardised Approach (CRR) Part or Article 114(7) of CRR;
 - (b) both the exposure and the collateral are denominated in the same currency;
 - (c) either the maturity of the transaction is no more than one day or both the exposure and the collateral are subject to daily marking-to-market or daily re-margining;

- (d) the time between the last marking-to-market before a failure to re-margin by the counterparty and the liquidation of the collateral is no more than four business days;
- (e) the transaction is settled in a settlement system proven for that type of transaction;
- (f) the documentation covering the agreement or transaction is standard market documentation for securities financing transactions in the securities concerned;
- (g) the transaction is governed by documentation specifying that where the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the transaction is immediately terminable;
- (h) the counterparty is a core market participant, as set out in paragraph 3;
- (i) upon any default event, including in the event of the bankruptcy or insolvency of the counterparty, the JIB has an unfettered, enforceable right immediately to seize and liquidate the collateral for its benefit.

3. The following entities are core market participants:

- (a) the entities referred to in point (b) of paragraph 1 of Article 197 where exposures to such entities would be assigned a 0% risk weight under the Credit Risk: Standardised Approach (CRR) Part or under Article 114(7) of CRR;
- (b) JIBs;
- (ba) Financial Institutions exposures to which may be treated as exposures to Institutions under Credit Risk: Standardised Approach (CRR) Part Article 119(5);
- (c) other financial undertakings that are an insurance undertaking or reinsurance undertaking, an insurance holding company or a mixed financial holding company, where:
 - (i) such financial undertaking has a credit assessment by an ECAI and exposures to it would be assigned a 20% risk weight under the Standardised Approach; or
 - (ii) in the case of exposures where a JIB calculates risk-weighted exposure amounts and expected loss amounts using the IRB Approach, such financial undertaking is internally rated by the JIB using the IRB Approach and the internal rating indicates comparable or better credit quality than a credit assessment by an ECAI that would result in the condition in point (i) being met;
- (d) regulated CIUs that are subject to capital or leverage requirements;
- (e) regulated pension funds;
- (f) recognised clearing organisations.

4. Where a JIB is calculating the volatility adjustments to be applied for exposures subject to an eligible Master Netting Agreement under Article 220, the JIB may apply a 0% volatility adjustment under this Article only if all of the conditions in paragraph 2 are met for all transactions subject to the Master Netting Agreement.

Article 228 Calculating Risk-Weighted Exposure Amounts Using the Financial Collateral Comprehensive Method

1. A JIB using the Financial Collateral Comprehensive Method shall use E* as calculated under paragraph 5 of Article 223 as the exposure value for the purposes of Credit Risk: Standardised Approach (CRR) Part Article 113 and Credit Risk: Internal Ratings Based Approach (CRR) Part Articles 166A to 166C. In the case of off-balance sheet items, the JIB shall use E* as the value to which the percentages indicated in paragraph 1 of Credit Risk: Standardised Approach (CRR) Part Article 111 and in paragraph 1 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 166C, as applicable, shall be applied to arrive at the exposure value.

2. [Note: Provision left blank]

Article 229 Valuation Principles for Other Eligible Collateral under the Foundation Collateral Method

A1. This Article applies to a JIB using the Foundation Collateral Method.

1. For immovable property collateral, a JIB shall ensure the collateral is valued at or at less than, the market value by a suitably robust statistical method or by an independent valuer who possesses the necessary qualifications, ability and experience to execute a valuation. The JIB shall ensure that the market value is documented in a transparent and clear manner.

The value of the collateral shall be the market value reduced as appropriate:

- (a) to reflect the results of the monitoring required under paragraph 3 of Article 208;
- (b) to take account of any claims on the immovable property with priority over the JIB's claim.

This shall be done by reducing the value of the property by:

$$\frac{P}{1 - H_C - H_{fx}}$$

where:

P = total value of all claims ranking higher than the JIB's claim; H_C and H_{fx} are as determined pursuant to Article 230; and

- (c) subject to the prior application of point (b), if applicable, if there are other claims ranking equally with the JIB's claim, recognising only the proportion of the remaining value that is attributable to the JIB.

Where the calculations under this paragraph 1 result in a negative value, the JIB shall assign zero value to the collateral.

2. For receivables, a JIB shall use the amount receivable as the value of receivables.
3. For physical collateral other than immovable property, a JIB shall ensure the collateral is valued at, or at less than, its market value, by a suitably robust statistical method or by an independent valuer who possesses the necessary qualifications, ability and experience to execute a valuation.
4. For the purposes of this Article, the market value is the estimated amount for which the property would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction.

Article 230 Calculating Risk-Weighted Exposure Amounts and Expected Loss Amounts for Eligible Collateral under the Foundation Collateral Method

A1. This Article applies to a JIB using the Foundation Collateral Method.

1. Subject to Article 231, a JIB shall use the effective LGD (LGD*) as the LGD for the purposes of the Credit Risk: Internal Ratings Based Approach (CRR) Part. The JIB shall calculate LGD* as follows:

$$LGD^* = LGD_U \cdot \left(\frac{E_U}{E \cdot (1 + H_E)} \right) + LGD_S \cdot \left(\frac{E_S}{E \cdot (1 + H_E)} \right)$$

where:

- E = the exposure value (E) calculated in accordance with paragraph 3 of Article 223;
- H_E = the volatility adjustment appropriate to the exposure, as calculated under Articles 224, 226, and 227;
- E_S = the current value of the collateral received after the application of:
 - (a) the volatility adjustment applicable for the type of collateral (H_C), as specified in paragraph 2;
 - (b) a volatility adjustment for any currency mismatches between the exposure and the collateral (H_{fx}) in accordance with Articles 224, 226, and 227;
 - (c) an adjustment for any maturity mismatches calculated in accordance with Articles 237 to 239.

E_S is capped at the value of $E \cdot (1 + H_E)$;

- $E_U = E \cdot (1 + H_E) - E_S$;
 - LGD_U = the LGD that would be applicable if the exposure were unsecured, as set out in paragraph 1 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 161;
 - LGD_S = the LGD applicable to exposures secured by the type of collateral used in the transaction, as specified in paragraph 2.
3. The values of LGDS and HC are set out in the following table:

| Type of collateral | LGD_S | H_C |
|---------------------------|---------|---|
| Financial collateral | | Volatility adjustment calculated in accordance with Articles 224, 226 and 227 |
| Receivables | 20% | 40% |
| Immovable property | 20% | 40% |
| Other physical collateral | 25% | 40% |

Article 231 Calculating Risk-Weighted Exposure Amounts and Expected Loss Amounts in the Case of Mixed Pools of Collateral under the Foundation Collateral Method

A1. This Article applies to a JIB using the Foundation Collateral Method.

1. Where a JIB has obtained multiple types of collateral for an exposure, it shall calculate LGD^* in accordance with the formula below instead of the formula in paragraph 1

$$LGD^* = LGD_U \cdot \left(\frac{E_U}{E \cdot (1 + H_E)} \right) + \sum_i LGD_{S_i} \cdot \left(\frac{E_{S_i}}{E \cdot (1 + H_E)} \right)$$

where:

- E = the exposure value calculated in accordance with paragraph 3 of Article 223;
- H_E = the volatility adjustment appropriate to the exposure, as calculated under Articles 224 to 227;
- $E_{S_1} = \min\{C_1, E \cdot (1 + H_E)\}$, C_1 is capped at $E \cdot (1 + H_E)$;
- $E_{S_i} = \min\{C_i, E \cdot (1 + H_E) - \sum_{k=1}^{i-1} E_{S_k}\}$, for $i \geq 2$; $\sum_{k=1}^{i-1} E_{S_k}$ is capped at $E \cdot (1 + H_E)$;
- C_i = the current value of the collateral i received after the application of:
 - (b) the volatility adjustment applicable for the type of collateral (H_C), as specified in paragraph 2 of Article 230;
 - (c) a volatility adjustment for any currency mismatches between the exposure and the collateral (H_{fx}) in accordance with Articles 224, 226, and 227;

(d) an adjustment for any maturity mismatches calculated in accordance with Articles 237 to 239.

- $E_U = E \cdot (1 + H_E) - \sum_i E_{S_i}$;
- LGD_U = the LGD that would be applicable if the exposure were unsecured as set out in paragraph 1 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 161;
- LGD_{S_i} = the LGDs applicable to exposures secured by the type of collateral i , as specified in paragraph 2 of Article 230;
- i = the index that denotes all separate types of collateral obtained for the exposure. The JIB may assign types of collateral to this index in any order;
- k = the index that denotes all separate values of the index i .

2. For the purposes of paragraph 1,

- (f) collateral with a currency mismatch shall be considered a different type of collateral to collateral without a currency mismatch; and
- (e) multiple items of collateral of the same type and currency but with differing maturities shall be considered different types of collateral.

Article 232 Other Funded Credit Protection Method

A1. This Article applies to a JIB using the Other Funded Credit Protection Method.

1. Where the conditions set out in paragraph 1 of Article 212 are met, a JIB may treat cash on deposit with, or cash assimilated instruments issued by the JIB and held by, a third party Institution in a non-custodial arrangement and pledged to the JIB as a guarantee provided by the third party Institution, in which case the JIB shall take into account the credit protection in the calculation of the effect of credit risk mitigation for the purposes of calculating risk-weighted exposure amounts and, where applicable, expected loss amounts in accordance with Article 235 or 236 as determined in accordance with the decision tree in Part 3 of Appendix 1.
2. Where the conditions set out in paragraph 2 of Article 212 are met, a JIB shall determine the collateralised portion of the exposure based on the value of the credit protection set out in the second sub-paragraph. The JIB shall subject the portion of the exposure to the following treatment:
 - (a) where the exposure is subject to the Standardised Approach, it shall be assigned a risk weight in accordance with paragraph 3;
 - (b) where the exposure is subject to the Foundation IRB Approach, it shall be assigned an LGD of 40%.

The value of the credit protection shall equal the current surrender value of the life insurance policy except that in the event of a currency mismatch, the JIB shall reduce the value of the credit protection in accordance with paragraphs 3 and 4 of Article 233.

3. For the purposes of point (a) of paragraph 2, the JIB shall assign the following risk weights on the basis of the risk weight assigned to a senior unsecured exposure to the undertaking providing the life insurance under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR:
 - (a) a risk weight of 20%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 20%;
 - (b) a risk weight of 35%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 30% or 50%;
 - (c) a risk weight of 70%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 65%, 100% or 135%;
 - (d) a risk weight of 150%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 150%.
4. A JIB may treat instruments repurchased on request that are eligible under point (c) of paragraph 1 of Article 200 as a guarantee by the issuing Institution, in which case the JIB shall calculate risk-weighted exposure amounts and, where applicable, expected loss amounts in accordance with Article 235 or 236 as determined in accordance with the decision tree in Part 3 of Appendix 1. The value of the eligible credit protection shall be the following:
 - (a) where the instrument will be repurchased at its face value, the value of the protection shall be that amount;
 - (b) where the instrument will be repurchased at market price, the value of the protection shall be the value of the instrument valued in the same way as the debt securities that meet the conditions in paragraph 4 of Article 197.
5. A JIB using the Other Funded Credit Protection Method shall take into account any maturity mismatch in accordance with the provisions of Articles 237 to 239.

Sub-Section 2 Unfunded Credit Protection

Article 233 Valuation under the Risk-Weight Substitution Method and the Parameter Substitution Method

1. For the purpose of calculating the effects of unfunded credit protection in accordance with Subsection 2 of Section 4, a JIB using the Risk-Weight Substitution Method or the Parameter Substitution Method shall, subject to paragraph 2, use as the value of unfunded credit protection (G) the amount that the protection provider has undertaken to pay in the event of the default or non-payment of the borrower or on the occurrence of other specified credit events.
2. In the case of credit derivatives which do not include as a credit event restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that result in a credit loss event, the JIB shall (unless paragraph 3 of Article 216 applies) apply the following:
 - (a) where the amount that the protection provider has undertaken to pay is not higher than the exposure value, the JIB shall reduce the value of the credit protection calculated under paragraph 1 by 40%;

(b) where the amount that the protection provider has undertaken to pay is higher than the exposure value, the JIB shall ensure that the value of the credit protection shall be no higher than 60% of the exposure value.

3. The JIB shall adjust the amount of credit protection for foreign exchange risk as follows:

$$G^* = G \cdot (1 - H_{fx})$$

where:

G^* = the amount of credit protection adjusted for foreign exchange risk;

G = the value of the credit protection as determined by paragraph 1 and 2;

H_{fx} = the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation determined in accordance with paragraph 4.

Where there is no currency mismatch H_{fx} is equal to zero.

The JIB shall base the volatility adjustments for any currency mismatch on a 10 business day liquidation period, assuming daily revaluation, and shall calculate them using the volatility adjustments as set out in Article 224. The JIB shall scale up the volatility adjustments in accordance with paragraph 1 of Article 226 where applicable.

Article 234 Calculating risk-weighted exposure amounts and expected loss amounts in the event of partial protection and tranching

1. Where a JIB transfers a part of the risk of a loan in one or more tranches, the JIB shall comply with the requirements set out in Chapter 5 of Title II of Part Three of CRR. A JIB shall consider materiality thresholds on payments below which no payment shall be made in the event of loss to be equivalent to retained first loss positions and to give rise to a tranching transfer of risk.

Article 235 Calculating Risk-Weighted Exposure Amounts under the Risk-Weight Substitution Method

1. For the purposes of point (1) of the definition of Risk-Weight Substitution Method, the JIB shall separate each exposure into a covered part and an uncovered part, and determine the size of these parts and the risk weights that apply to each part separately as follows:

(a) The covered part shall be the portion of the exposure that is in scope of the unfunded credit protection. The size of this part prior to the application of any applicable conversion factors, E_g , shall equal $\min\{GA, E\}$, where:

E =

(i) for exposures where the JIB calculates risk-weighted exposure amounts using the Standardised Approach, the exposure value in accordance with Credit Risk: Standardised Approach (CRR) Part Article 111, with the exception that for the purposes of this paragraph the exposure value of an off-balance sheet item shall be 100% of its value;

- (ii) for exposures where the JIB calculates risk-weighted exposure amounts using the IRB Approach, the exposure value in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Articles 166A to 166D, with the exception that for the purposes of this paragraph the exposure value of an off-balance sheet item shall be 100% of its value;

GA = the amount of credit risk protection as calculated under paragraphs 3 and 4 of Article 233 (G*), further adjusted for any maturity mismatch as laid down in 237 to 239.

The risk weight that applies to the covered part shall be: r_g = the risk weight of a comparable direct exposure to the protection provider as specified under the Credit Risk: Standardised Approach (CRR) Part and Chapter 2 of Title II of Part Three of CRR.

- (b) The uncovered part shall be the remainder of the exposure, and the size of this part prior to the application of any applicable conversion factors, E_n , shall be calculated by subtracting the size of the covered part (E_g) from the size of the total exposure (E).

The risk weight that applies to the uncovered part shall be:

r_n = the risk weight of the exposure calculated as if there were no unfunded credit protection.

- (c) Having made these calculations, the risk weight that shall apply to such exposure in its entirety is determined by the following formula:

$$\frac{E_n \cdot r_n + E_g \cdot r_g}{E}$$

where E , in respect of the entire exposure, is determined as in point (a).

- 1A. For the purposes of point (2) of the definition of Risk-Weight Substitution Method, the JIB shall calculate the expected losses separately for the covered and uncovered parts of the exposure as follows:

- (a) The expected loss for the uncovered part, e_n , shall be the expected loss of the exposure calculated in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Article 158 as if there was no unfunded credit protection.

- (b) The expected loss for the covered part, e_g , shall be zero.

- (c) Having made these calculations, the expected loss that shall apply to such exposure in its entirety is determined by the following formula:

$$\frac{E_n \cdot e_n}{E}$$

where:

E is determined as in point (a) of paragraph 1; and

E_n is determined as in point (b) of paragraph 1.

2. Where the protected amount (GA) is less than the exposure (E), the JIB may apply the formula specified in paragraphs 1 and 1A only where the protected and unprotected parts of the exposure are of equal seniority.
3. For the purpose of applying paragraph 1, a JIB may only apply the treatment set out in paragraph 4 of Credit Risk: Standardised Approach (CRR) Part Article 114 and Article 114(7) of CRR to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of that central government or central bank and the exposure is funded in that currency.

Article 236 Calculating Risk-Weighted Exposure Amounts and Expected Loss Amounts under the Parameter Substitution Method

1. For the purposes of point (1) of the definition of Parameter Substitution Method, the JIB shall separate each exposure into a covered part and an uncovered part, and determine the size of these parts and the risk weights that apply to each part separately as follows:

(a) The covered part shall be the portion of the exposure that is in scope of the unfunded credit protection. The size of this part prior to the application of any applicable conversion factors, E_g , shall equal $\min\{GA, E\}$, where:

E = the exposure value in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Articles 166A to 166D, with the exception that for the purposes of this paragraph the exposure value of an off-balance sheet item shall be 100% of its value;

GA = the amount of credit risk protection as calculated under paragraphs 3 and 4 of Article 233 (G^*) further adjusted for any maturity mismatch as laid down in Articles 237 to 239.

The risk weight that applies to the covered part shall be:

$r_g =$

(i) where a comparable direct exposure to the protection provider would be assigned to the 'exposures to institutions' or 'exposures to corporates' class in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Article 147, the risk weight calculated in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Article 153 where:

PD = the PD which would be assigned to a comparable direct exposure to the protection provider calculated in accordance with the Credit Risk: Internal Ratings Based Approach (CRR) Part, after application of the input floor specified in paragraph 1 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 160, and increased as necessary to comply with the obligation in paragraph 4 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 160;

LGD = the LGD of the exposure calculated as if there were no unfunded credit protection calculated in accordance with the Credit Risk: Internal Ratings Based Approach (CRR) Part, after application of the input floor specified in paragraph 5 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 161 in accordance with paragraph 6 of Credit Risk: Internal Ratings

Based Approach (CRR) Part Article 161. The JIB may instead choose to apply the LGD that would be applicable to the guarantee under the Foundation IRB Approach if it were a direct exposure to the protection provider taking into account the seniority of the guarantee. In either case such LGD shall be increased as necessary to comply with the obligation in paragraph 4 of Credit Risk: Internal Ratings Based

Approach (CRR) Part Article 160 as referred to in paragraph 3 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 161;

M = the maturity of the exposure calculated in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Article 162;

R = the correlation coefficient that would be assigned to a comparable direct exposure to the protection provider;

- (ii) where a comparable direct exposure would be assigned to the 'retail exposures' class in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Article 147, the risk weight calculated in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Article 154 where:

PD = the PD which would be assigned to a comparable direct exposure to the protection provider calculated in accordance with the Credit Risk: Internal Ratings Based Approach (CRR) Part, after application of the input floor specified in paragraph 1 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 163, and increased as necessary to comply with the obligation in paragraph 4 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 163;

LGD = the LGD of the exposure calculated as if there were no unfunded credit protection calculated in accordance with the Credit Risk: Internal Ratings Based Approach (CRR) Part, after application of the input floor specified in paragraph 4 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 164 in accordance with paragraph 4A of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 164, and increased as necessary to comply with the obligation in paragraph 4 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 163 as referred to in paragraph 2 of Credit Risk: Internal Ratings Based Approach (CRR) Part Article 164;

R = the correlation coefficient that would be assigned to a comparable direct exposure to the protection provider.

- (b) The uncovered part shall be the remainder of the exposure, and the size of this part prior to the application of any applicable conversion factors, E_n shall be calculated by subtracting the size of the covered part (E_g) from the size of the total exposure (E) as defined in point (a).

The risk weight that applies to the uncovered part shall be:

r_n = the risk weight of the exposure calculated as if there were no unfunded credit protection.

- (c) Having made these calculations, the risk weight that shall apply to such exposure in its entirety is determined by the following formula:

$$\frac{E_n \cdot r_n + E_g \cdot r_g}{E}$$

where E, in respect of the entire exposure, is determined as in point (a).

1A. For the purposes of point (2) of the definition of Parameter Substitution Method, the JIB shall calculate the expected loss separately for the covered and uncovered parts of the exposure as follows:

- (a) The expected loss for the uncovered part, e_n , shall be the expected loss of the exposure calculated in accordance with Credit Risk: Internal Ratings Based Approach (CRR) Part Article 158 as if there were no unfunded credit protection.
- (b) The expected loss for the covered part, e_g , shall be $PD \cdot LGD$, where PD and LGD are as defined for the purposes of calculating r_g in point (a) of paragraph 1.
- (c) Having made these calculations, the expected loss that shall apply to such exposure in its entirety is determined by the following formula:

$$\frac{E_n \cdot e_n + E_g \cdot e_g}{E}$$

where E, in respect of the entire exposure, is determined as in point (a) of paragraph 1.

2. [Note: Provision left blank]

3. [Note: Provision left blank]

Section 5 Maturity Mismatches

Article 237 Maturity Mismatch

A1. This Article only applies to a JIB using one of the methods set out in paragraph 1A of Article 238.

1. For the purpose of calculating risk-weighted exposure amounts, a maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected exposure. Where protection has a residual maturity of less than three months and the maturity of the protection is less than the maturity of the underlying exposure a JIB shall not use that protection as eligible credit protection.
2. Where there is a maturity mismatch, a JIB shall not use the credit protection as eligible credit protection where either of the following conditions is met:
 - (a) the original maturity of the protection is less than one year;
 - (b) the exposure is a short-term exposure that is subject to a one-day floor in respect of the maturity value (M) under paragraph 3 of Credit Risk: Internal Ratings Based Approach Part Article 162.

Article 238 Maturity of Credit Protection

1. A JIB using any of the methods set out in paragraph 1A shall take the effective maturity of the underlying to be the longest possible remaining time before the obligor is scheduled to fulfil its obligations, subject to a maximum of five years. Subject to paragraph 2, the JIB shall take the maturity of the credit protection to be the time to the earliest date at which the protection may terminate or be terminated; except that, solely in the case of point (a) of paragraph 1A, this shall be the time to the earlier of (a) the date when the netting agreement may terminate or be terminated and (b) the date when the deposit with the JIB can be withdrawn or the loan to the JIB called.

1A. The methods are:

- (a) On-Balance Sheet Netting;
- (b) the Financial Collateral Comprehensive Method, but not where it is used for securities financing transactions with a Master Netting Agreement;
- (c) the Foundation Collateral Method;
- (d) the Other Funded Credit Protection Method;
- (e) the Risk-Weight Substitution Method;
- (f) the Parameter Substitution Method.

2. Where there is an option to terminate the protection which is at the discretion of the protection seller, the JIB shall take the maturity of the protection to be the time to the earliest date at which that option may be exercised. Where there is an option to terminate the protection which is at the discretion of the protection buyer:

- (a) if the terms of the arrangement at origination of the protection contain a positive incentive for the JIB to call the transaction before contractual maturity, the JIB shall take the maturity of the protection to be the time to the earliest date at which that option may be exercised;
- (b) otherwise the JIB may consider that such an option does not affect the maturity of the protection.

3. The JIB shall reduce the maturity of protection by the length of the grace period where all of the following conditions are met:

- (a) the credit protection is in the form of a credit derivative;
- (b) the underlying contract allows a grace period before there is a default as a result of a failure to pay;
- (c) the credit derivative is not prevented from terminating prior to expiration of the grace period.

Article 239 Valuation of Credit Protection

1. For transactions subject to funded credit protection where there is a mismatch between the maturity of the exposure and the maturity of the credit protection, a JIB using the Financial Collateral Simple Method shall not use the collateral as eligible funded credit protection.
2. For transactions subject to an eligible on-balance sheet netting agreement or subject to funded credit protection, a JIB using any of the methods set out in points (a) to (d) of paragraph 1A of Article 238 shall reflect the maturity of the credit protection and of the exposure in the adjusted value of the collateral in accordance with the following formula:

$$C_{VAM} = C_{VA} \cdot \frac{(t - t^*)}{(T - t^*)}$$

where:

- C_{VA} = the volatility adjusted value of the collateral as specified in paragraph 2 of Article 223 or the amount of the exposure, whichever is lower;
- t = the number of years remaining to the maturity date of the credit protection calculated in accordance with Article 238, or the value of T , whichever is lower;
- T = the number of years remaining to the maturity date of the exposure calculated in accordance with Article 238, or five years, whichever is lower;
- t^* = 0.25.

A JIB using the Financial Collateral Comprehensive Method shall use C_{VAM} as CVA further adjusted for maturity mismatch in the formula for the calculation of the fully adjusted value of the exposure (E^*) set out in paragraph 5 of Article 223.

3. For transactions subject to unfunded credit protection, a JIB using either of the methods set out in points (e) or (f) of paragraph 1A of Article 238 shall reflect the maturity of the credit protection and of the exposure in the adjusted value of the credit protection in accordance with the following formula:

$$G_A = G^* \cdot \frac{t - t^*}{T - t^*}$$

where:

- G_A = G^* adjusted for any maturity mismatch;
- G^* = the amount of the credit protection adjusted for any currency mismatch;
- t = the number of years remaining to the maturity date of the credit protection calculated in accordance with Article 238, or the value of T , whichever is lower;
- T = the number of years remaining to the maturity date of the exposure calculated in accordance with Article 238, or five years, whichever is lower;
- t^* = 0.25.

The JIB shall use G_A as the amount of credit protection further adjusted for maturity mismatch for the purposes of Article 235 to 236.

Section 6 Basket CRM Techniques

Article 240

[Note: Provision left blank]

Article 241

[Note: Provision left blank]

Near Final Draft

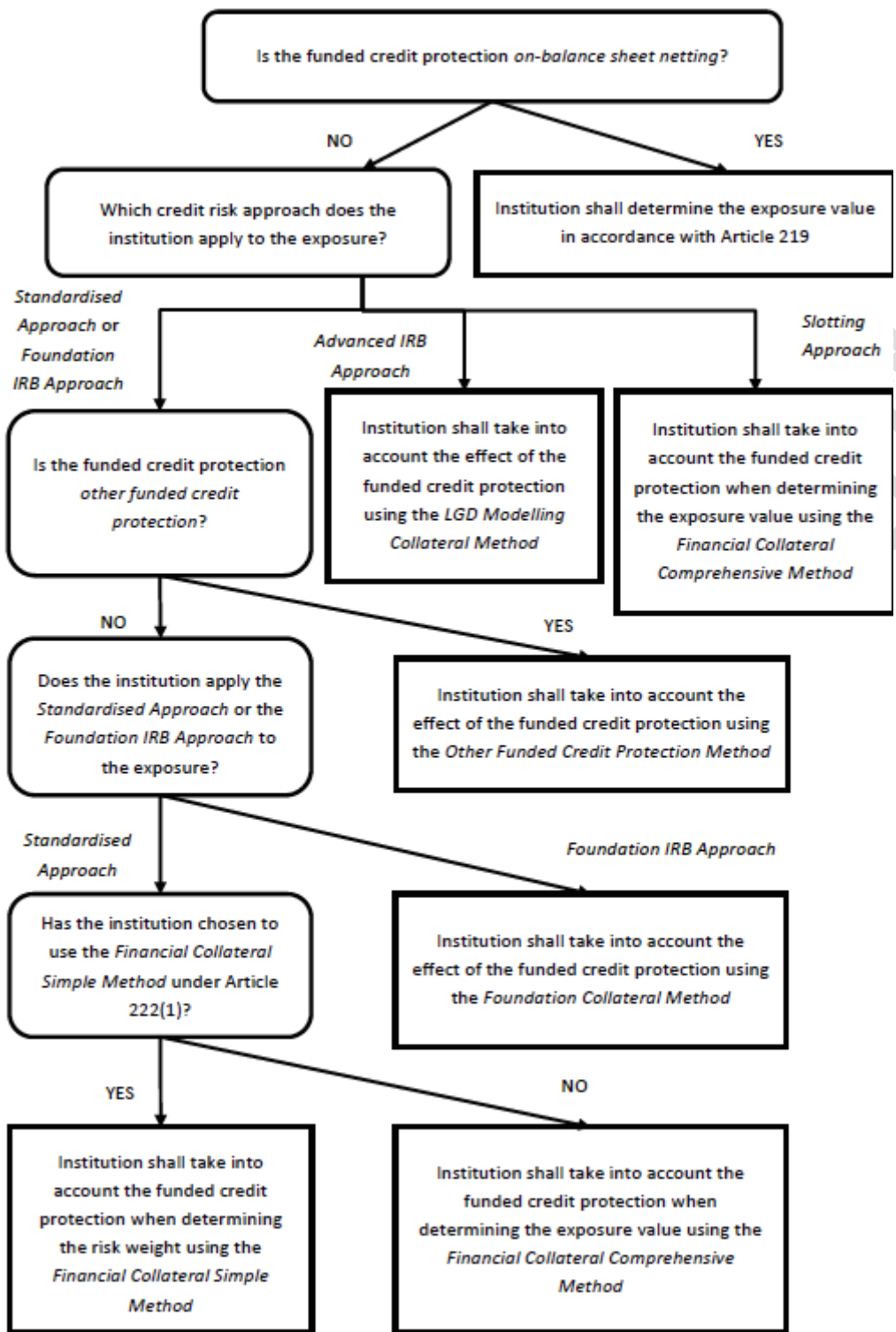
Appendix 1

Part One: Funded Credit Protection Covering an Exposure that Gives Rise to Counterparty Credit Risk

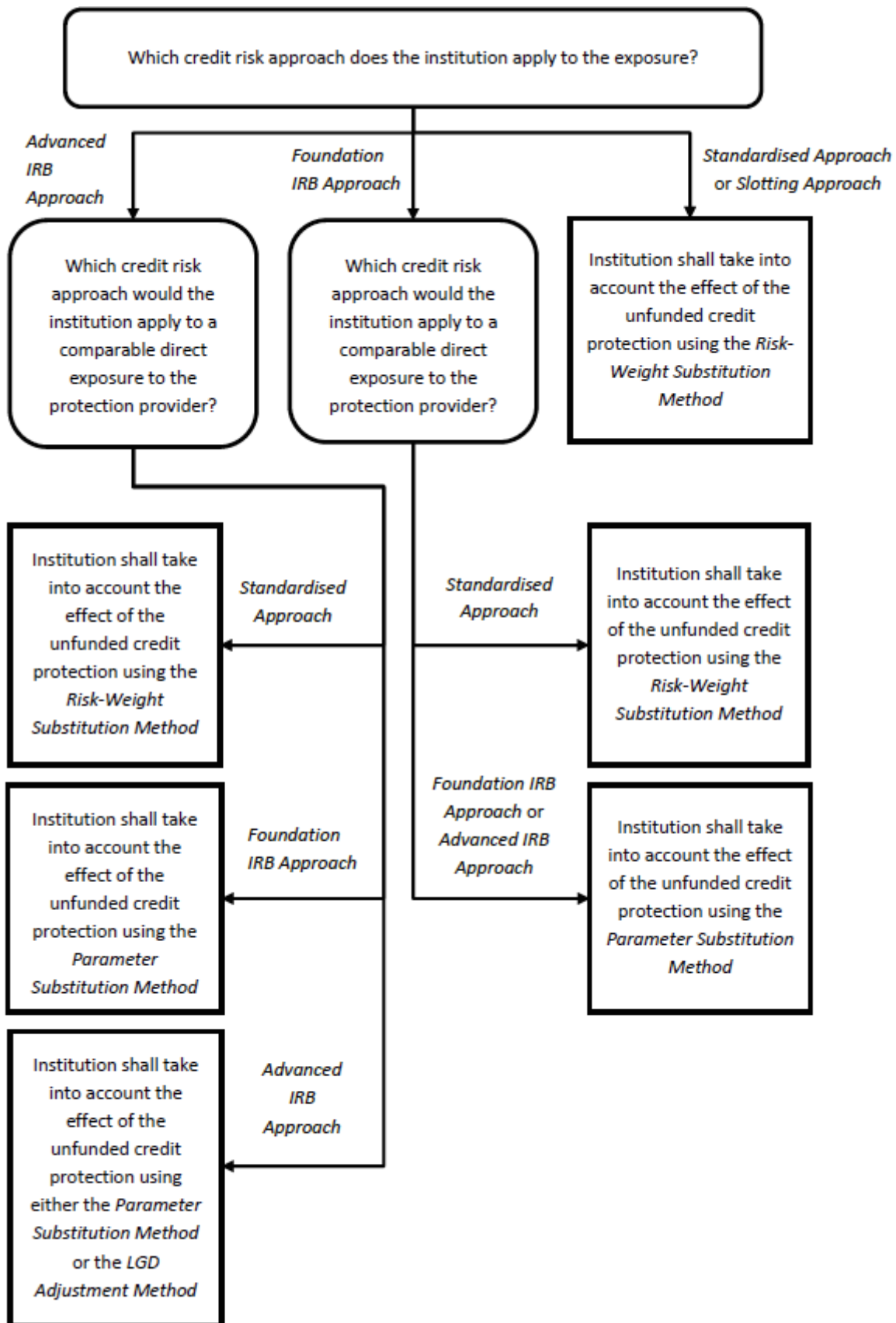
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Near Final Draft

Part Two: Funded Credit Protection Covering an Exposure that Does Not Give Rise to Counterparty Credit Risk



Part Three: Unfunded Credit Protection Covering an Exposure



Part Four: Exposure Covered by Unfunded Credit Protection which is Covered by Funded Credit Protection

