



Application for IRB approach, credit risk

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1. Summary

This report contains Finansinspektionen's instructions regarding the manner in which an institution or financial group should structure its information when applying to use an internal ratings-based methodology for calculation of the capital requirement for credit risk.

Questions regarding this report will be answered by the Credit and Operational Risk Unit at Finansinspektionen's Stability Department.

2. Background

The Capital Adequacy and Large Exposures Act (2006:1371) and the Capital Adequacy and Large Exposures Ordinance (2006:1533) entered into force on 1 February 2007. Pursuant to sections 32–34 of the Ordinance, Finansinspektionen has decided on regulations and general guidelines (FFFS 2007:1) for capital adequacy and large exposures. In accordance with these new rules, institutions, i.e. banks, credit market companies and investment firms, may apply for permission to use an internal ratings based approach, the IRB approach, to calculate the capital requirement for credit risk. Finansinspektionen issues this type of permission, and its review of the reliability of the institution's methods is based on FFFS 2007:1.

An institution intending to apply for permission to use an IRB approach should contact Finansinspektionen well in advance of the formal submittance of the application in order to start a dialogue and discuss an appropriate date for permission. This procedure is required in order to allow Finansinspektionen to allocate and distribute needed resources.

The requirements imposed for using an IRB approach are relatively extensive. Consequently, Finansinspektionen must receive from institutions relatively extensive information in order to assess the quality of their IRB approach. Finansinspektionen has therefore compiled an instruction outlining which type of information the institution should submit in order for Finansinspektionen to be able to assess the institution's compliance with the requirements set out in the individual sections of the regulations.

This application can be used by institutions submitting an initial request for a review and by institutions that requested a gradual implementation and are about to submit supplementing information for the portfolios that will be reviewed. The application should also be used by institutions that at a later stage, after an initial review, will apply for permission in accordance with Chapter 38, section 6.

3. General information regarding the review procedure

3.1.1 Scope and gradual implementation

A financial group may submit an application covering the capital requirement calculation on a consolidated basis and on an individual basis for the parent company and subsidiaries included in the group. (In the text below we refer to the institution as the applicant, however, the application may be submitted on group basis for the parent company and the subsidiaries included in the financial group.)

Institutions which do not constitute subsidiaries but where the owner firm only holds a participating interest, i.e. the owner firm owns more than 20% but less than 50%, shall submit a separate application. In cases where such a firm is organisationally closely affiliated to the owner firm and the financial group in the development and use of IRB approaches, the firm may also be included in the financial group's application. However, if the firm chooses such a solution, it is important that this joint application contains sufficient information to enable Finansinspektionen to assess the firm's compliance with the requirements in the regulations on an individual basis. The responsibility in this case lies with the firm itself (in which the owner firm holds a participating interest).¹

The application the institution submits to Finansinspektionen covers only the portfolios for which the institution intends to use the IRB approach as of the date for permission or for which an institution has chosen a gradual implementation of the IRB approach that will now be reviewed. Institutions applying for an initial review also need to submit information about other portfolios (Table 3). The application for these portfolios shall only contain such information that is necessary for Finansinspektionen to assess the institution's compliance with the requirements for time-limited or permanent exceptions from the IRB approach.

Institutions gradually implementing the IRB approach shall at a later date submit supplementary information for the portfolios that are covered in the initial application. The same questionnaire shall be filled in for such portfolios, although references to the previous application may be made where appropriate. This supplementary information shall be submitted well in advance of the institution's intended start date for the IRB approach for the portfolios in question. In conjunction with the initial permission, Finansinspektionen and the institution shall jointly agree on a timetable for the manner in which the process of reviewing such portfolios will take place.

3.1.2 Permission in accordance with Chapter 38, section 6

Institutions which received permission after an initial application to use an IRB approach and that at a later stage will apply for permission in accordance with Chapter 38, section 6 shall answer the same questionnaire,

¹ This can be relevant for a number of minimum requirements, for example the assessment of whether the different threshold values are fulfilled in order to be excepted from IRB, information from the credit risk control unit and the requirement that an internal audit be carried out. (Note that this list is not comprehensive.)

although references to the previous application may be made where appropriate.

3.1.3 *Signature and supplements*

As set out in table 1 of the Flyleaf, the Managing Director of the parent company and the Managing Director of each subsidiary, which is an institution, shall sign the application. This also applies to any subsequent supplementations to the application. However, Finansinspektionen believes a more flexible solution would be if the individual institution covered by the application were to provide the parent company (or where applicable owner firm) with power of attorney to submit such supplementary information. Such powers of attorney shall be appended to the application.

Institutions gradually implementing the IRB approach only need to sign the initial application for review.

3.1.4 *Parallel reporting*

Institutions applying for permission to use an IRB approach shall be able to show that they can correctly calculate and report the capital requirement in accordance with the IRB approach.² The institution shall, in parallel with the regular capital adequacy report, report four times a year at quarterly intervals. The reporting shall take place on a consolidated basis and include the exposures for which the institution intends to calculate the capital requirement in accordance with the IRB approach as of the date permission is granted. Exposures and portfolios that will be implemented gradually shall also be reported in parallel.

² FFFS 2007:1 Chapter 44, section 47.

4. Formulation of application

4.1.1 *Format*

It would be appreciated if the institution would submit the application and appended documentation electronically. However, for obvious reasons this does not apply to signatures. Appended documentation should be numbered to facilitate the administration.

4.1.2 *Language*

The institution may respond to questions in Swedish or English, unless otherwise agreed. This will facilitate the assessment of foreign branch offices and subsidiaries and render possible efficient co-operation with foreign supervisory bodies in such assessment.

4.1.3 *Content*

Some of the sections of the regulations are not addressed directly in the questionnaire. This does not mean that Finansinspektionen will not assess compliance with these sections. We believe that other sections will provide the information we need to make such assessments.

4.1.4 *Different replies for different approaches/portfolios*

An IRB approach covers, in practice, a large number of different methods that are used for different risk dimensions and different portfolios. In the fly sheet in the next section, the institution shall state its assignment of exposures in various grading methods. Approaches shall also be designated, for example PD-1, PD-2, PD-3 and LGD-A, LGD-B. By stating prior to each reply the method or methods to which the reply relates, Finansinspektionen is able, with the aid of the completed tables, to see which of the institution's assets the replay relates. The institution may need to provide multiple replies to the same question if the answers differ regarding different methods.

A sample answer is presented on the next page. (Note that the replies in the example are not intended to serve as guidance as to how the institution should structure its credit processes, but only as an instruction as to the manner in which the information in a reply might be structured.)

59. From FFFS 2007:1 Chapter 42, section 11:

“All exposures shall be assigned to a risk grade.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

LGD-A, LGD-B:

Regarding exposures to individuals, risk grading automatically takes place in all three dimensions, including the LGD dimension, before credit is extended. This is stated on page 2 of the document “09 Credit instructions, retail.doc”.

LGD-C, LGD-D:

Each person responsible for customers at commercial banks shall ensure that all counterparties and exposures are assigned a grade in all three risk dimensions, including the LGD dimension. A flag will automatically come up in the information system when an exposure does not have a risk grade for LGD. Each month, the risk control unit shall report thereon to the unit managers.

The requirement imposed on persons responsible for customers is set forth in “12 Credit instructions, commercial banks.pdf”, page 22, paragraph 2. Procedures for follow-up and design of reports are set out in “23 Manual follow-up, risk classification.pdf”. An example of this type of report is also included, see “41 Monthly follow-up, May 05.doc”.

5. Flysheet

Institutions intending to submit an initial application for review must reach an agreement with Finansinspektionen for a preliminary date for permission to use the IRB approach. The planned date is written in the box prior to Table 1.

5.1.1 Table 1

As described above, a financial group only needs to submit a single application for all of the subsidiaries included in the group, both on a consolidated basis and an individual basis³. The application shall indicate which subsidiaries are included in the financial group. In addition, both the Managing Director of the parent company and the Managing Director of each legal entity that is an institution (i.e. also Managing Directors for subsidiaries that shall also fulfil the capital adequacy requirements on an individual level) shall sign the application. This shall be set forth in table 1. Please also state in this table which institutions will not use the IRB approach commencing the planned date for permission, but will use the approach at a later date. The application includes these firms since all exposures in all subsidiaries within the financial group shall be included in the IRB approach after the end of the introduction period in accordance with the main rule. For this reason, we would also like the Managing Directors for these firms to sign the application.

Table 1 can be used for this purpose. If the number of lines is insufficient, the table may be copied or expanded. If it facilitates administration, the Managing Director of each company can also sign a separate piece of paper appended to the application. (As set out on page 3, a flexible solution for handling any supplements is that all legal entities covered by the application provide the parent company with a power of attorney to submit such supplements. The power of attorney shall be appended to the application.)

This table only needs to be filled in for the initial application for review and not for the roll-out of portfolios for institutions that are gradually implementing the IRB approach or are applying for permission in accordance with Chapter 38, section 6.

5.1.2 Table 2

5.1.3 Purpose

An IRB approach covers in practice a large number of different methods that are used for various risk dimensions and different parts of portfolios and can be particularly complex in a large financial group. It is easier for Finansinspektionen to form a picture of which methods are covered in the application if the institution sets forth in a table the internal breakdown of its exposures into different portfolios, business lines and methods.

The institution may need to provide multiple replies for the same question if the replies differ for each approach and part of the institution. By stating table 2's designations of the institution's different portfolios and methods

³ As set out on page 3, the application may also include firms where the owner firm holds a participating interest.

prior to each response, Finansinspektionen is able to see which approach and which part of the institution's assets the reply relates to.

This information also facilitates Finansinspektionen's planning of co-operation with foreign supervisory authorities where relevant.

5.1.4 Instructions

In table 2 of the fly sheet, the institution shall state its allocation of exposures in different portfolios and rating methods for portfolios that will be included in the application. The institution's internal allocation shall be provided; therefore, the institution may use its internal designations for the different portfolios and approaches. The institution shall state:

- The name of the portfolio (internal designation)

The portfolio's designation shall include the country in which the portfolio is located.

- Exposure class (in accordance with the definitions in the regulations)
- The business line to which the portfolio belongs (internal designation)
- The legal entity to which the portfolio belongs
- The volume of the assets in the portfolio

The volumes in the consolidated balance sheet are to be stated. Internal group exposures that are not visible in the consolidated balance sheet do not need to be stated if the institution does not intend to use the IRB approach with respect to them.

The volume shall be stated prior to netting and conversion factors.

- The rating methods used for the portfolio (internal designation)

Mark with an F in the conversion factor (CF) and LGD columns where prescribed values are used. With respect to foreign portfolios, indicate before the name of the method, using L for local and C for central, where the method has primarily been developed.

If the number of lines is insufficient, the table may be copied or expanded.

5.1.5 Table 3

In table 3 of the flysheet, the institution shall state its allocation of the exposures in different portfolios and rating methods for the portfolios that will *not* be included in the application. In other words, the portfolios the institution would like to exclude from the IRB approach, either temporarily or permanently. The institution shall also state in which year the institution plans to commence use of the IRB approach for each portfolio.

If the number of lines is insufficient, the table may be copied or expanded.

This table only needs to be filled in during an initial application for review and not during roll-out of portfolios for institutions that are gradually implementing the IRB approach.

5.1.6 Table 4

Within the scope of an IRB application, an institution may choose to apply for a number of additional permissions. In such case, the institution shall state this intention in table 4. The permissions that may be relevant should be listed in the table. Additional information required for the permission is requested in conjunction with each section.

5.1.7 Table 5

Finansinspektionen's assessment of the institution's IRB approach will largely be based on the institution's internal documentation. It is therefore requested that the institution refer to the relevant internal documents in conjunction with each section (as specific references as possible are requested). FI requests that the institution list in table 5 all documents appended to the application and to which the institution refers to in connection with the various sections.

Finansinspektionen would greatly appreciate if the document names begin with a number and in as clear a manner as possible indicate the content of the document. Where relevant, documents shall state which body established the document and at what time.

If the number of lines is insufficient, the table may be copied or expanded.

– Date agreed on with Finansinspektionen

Planned date for permission:

Flysheet Table 1

– List of legal entities covered by the application

Information about the financial group		
Contact person regarding the application:	Title	Telephone and e-mail

Information about the financial group		
Name of the financial group:	MD, parent company:	Signature
Information about subsidiaries that are institutions within the financial group		
Name of the subsidiary	MD	Signature
Information about institutions within the financial group where the owner firm has participating interests (if such are covered by the application):		
Name of the firm	MD	Signature

Flysheet Table 4

- Any additional permissions

Permission*	Will apply (if yes, mark with an X)
Chapter 38, section 15	
Chapter 38, section 18, second paragraph	
Chapter 38, section 19	
Chapter 38, section 20	
Chapter 38, section 21	
Chapter 38, section 22	
Chapter 39, section 5, last paragraph	
Chapter 39, section 23, first paragraph	
Chapter 40, section 43, second paragraph	
Chapter 41, section 16	
Chapter 42, section 20, second paragraph	
Chapter 44, section 47, last paragraph	

* Permission for the sections in Chapter 38 only need to be answered by institutions applying for an initial review of its IRB method and not for portfolios subject to gradual implementation.

Flysheet Table 5**- Reference library – appended documents**

Document name
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6. Application questionnaire

The following format provides the basis for the structure of the institution's application for review. References and quotations are to sections from Finansinspektionen's regulations and general guidelines (FFFS 2007:1) regarding capital adequacy and large exposures.

1. From FFFS 2007:1 Chapter 37, section 1:

“Each exposure shall be assigned to one of the following exposure classes:

- 1. exposures to governments,*
- 2. exposures to institutions,*
- 3. exposures to corporates,*
- 4. retail exposures,*
- 5. equity exposures,*
- 6. securitisation positions, and*
- 7. non credit-obligation assets.*

The procedures for assigning exposures to different exposure classes shall be appropriate to the task and consistent over time. The procedures shall be documented.”

State the manner in which the institution complies with the final paragraph of the above provision:

Instructions for how the institution's reply should be formulated:

Describe the assignment into different exposure classes and the criteria governing this assignment. Also describe where in the credit processes the assignment takes place in practice and by whom it is carried out.

Refer to sections in policy documents or manuals for assignment into exposure classes that describe the manner in which the work shall be carried out in practice. If specific IT support is available for such work, provide information about this support.

2. From FFFS 2007:1 Chapter 37, section 2:

“Exposures to governments refers to exposures to governments and central banks. This exposure class also includes exposures to

- 1. a Swedish local authority or comparable entity,*
- 2. a foreign local authority or comparable entity where such are treated as government exposures in the country in question,*
- 3. a multilateral development bank or international organisation which attracts a risk weight of 0% under the standardised approach for credit risk, and*
- 4. a public body which according to the standardised approach for credit risk may be treated as exposures to governments.”*

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution’s reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as an exposure to governments. Refer in the reply to the sections in appended policy documents or manuals where the criteria for assigning an exposure to exposures to governments are set forth. State in particular the manner in which the institution ensures that an exposure to a municipality in another country may be treated as an exposure to governments in that country (see point 2 in the provision).

3. From FFFS 2007:1 Chapter 37, section 3:

“Exposures to institutions refer to exposures to credit institutions and investment firms which are licensed in accordance with Chapter 3, section 4, first paragraph, lines 4 and 5 of the Securities Operations Act(1991:981) and equivalent foreign companies. This exposure class also includes exposures to

- 1. a foreign local authority or comparable association if it is not treated as a government exposure in the country in question,*
- 2. a public body which according to the standardised approach for credit risk may be treated as exposures to institutions.*
- 3. a multilateral development bank which does not attract a risk weight of 0% under the standardised approach for credit risk, and*
- 4. Sveriges Allmänna Hypoteksbank.”*

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution’s reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as an exposure to institutions. Refer in the reply to the sections in appended policy documents or manuals where the criteria for assigning an exposure to exposures to institutions are set forth.

4. From FFFS 2007:1 Chapter 37, section 4:

"Retail exposures refers to claims or contingent claims on natural persons and exposure to small or medium-sized legal entities, where the total exposure of the institution and, where applicable, the financial group, to such legal entity is less than an amount corresponding to EUR 600,000. Where special cause exists, exposures to small or medium-sized legal entities up to a maximum of EUR 1 million may be assigned to the retail exposure.

When determining total exposure, all exposures to a client or group of connected clients with reciprocal relations shall be taken into consideration. When determining the total exposure, exposures where clients are late with payments shall also be included. However, exposures, which are secured by liens on residential property or site-leasehold rights to such real estate, collateral in properties intended for residential use on a third party's site or collateral in the form of shares in a tenant-owner association do not need to be included in the total exposure. The institution shall have taken reasonable measures to ensure that the total exposure does not exceed the stated limit. In this context, off-balance sheet commitments do not need to be included as exposures.

To be eligible for the retail exposure class, exposures shall in addition be treated by the institution in its credit processes risk management in a manner consistent with other retail exposures. The institution shall not treat the exposure individually as exposures to corporates. The exposure shall also be included in a portfolio consisting of a large number of exposures that are similarly managed."

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution's reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as a retail exposure. Refer in the reply to the sections in appended policy documents or manuals where the criteria for assigning an exposure to retail exposures are set forth. Highlight in particular differences in handling exposures between, on the one hand, small and medium-sized companies in retail portfolios and, on the other hand, large firms in corporate portfolios. Also describe why these differences are relevant with regard to the division into retail exposures and exposures to corporates.

The institution shall also state if it has exposures to small or medium-sized legal entities that exceed EUR 600,000 and are assigned to retail exposures. The reasons for why these exposures are classified as retail exposures shall also be provided.

The institution shall estimate and state the extent to which the institution risks failing with the addition of exposures in accordance with the second paragraph in the section, notwithstanding that the institution has “*taken reasonable measures*”, and the reasons therefore.

In the event unutilised credit facilities are not included in the addition, the institution shall state the manner in which it guarantees that the limit amount of EUR 600,000, alternatively EUR one million, is not exceeded, even temporarily. State the rules and procedures therefore.

5. From FFFS 2007:1 Chapter 37, section 5, second paragraph:

“Exposures secured by real estate collateral refers to retail exposures for which the institution's estimation of LGD is affected by recoveries from mortgages on real estate, site-leasehold rights, buildings constructed on property of a third party or collateral in the form of shares in a tenant-owner association. An exposure may be divided into two parts and treated as two separate exposures. Assignment to the sub-group shall be consistent.”

State the manner in which the institution assigns exposures to this sub-group:

Instructions for how the institution's reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as real estate collateral within retail exposures. Refer in the reply to the sections in appended policy documents or manuals where the criteria for assigning an exposure to real estate collateral are set forth.

Refer in particular to relevant documentation, for example methodology documentation related to LGD calculations in which it is stated that retail exposures are always assigned to this exposure class since *“estimation of LGD is affected by recoveries from mortgages on real estate, site-leasehold rights, buildings constructed on property of a third party or collateral in the form of shares in a tenant-owner society”* and thus are never assigned to “other” retail exposures.

6. From FFFS 2007:1 Chapter 37, section 5, third paragraph:

“Within retail exposures, the sub-group exposures secured by residential property and qualifying revolving retail exposures shall be distinguished from other retail exposures. An exposure is revolving when outstanding balances are permitted to fluctuate based on the counterparty's decisions to borrow and repay up to a limit established by the institution.

Exposures shall be regarded as qualifying revolving retail exposures if they meet the following conditions:

- 1. The exposure is to an individual person or persons.*
- 2. The exposure is unsecured. This condition does not need to be met for exposures resulting from credit facilities linked to transaction accounts. Where security exists for the exposure, the institution shall not take into consideration recovery attributable to this security when estimating LGD.*
- 3. In the qualifying revolving exposures sub-group, the maximum credit facility to a single counterparty is EUR 100,000.*
- 4. The institution can unconditionally and immediately cancel any undrawn portion of the credit facility. This requirement is fulfilled if the institution meets the requirement to the full extent allowable under consumer protection legislation.*
- 5. The institution shall be able to demonstrate that the portfolios in which the exposures are included have low volatility of loss rates relative to the average level of loss rates. This condition shall also be met individually for the grades for which the institution's expected default rate is low.”*

State the manner in which the institution assigns exposures to this sub-group:

Instructions for how the institution's reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as a qualified rolling exposure within retail exposures. Refer in the reply to the sections in appended policy documents or manuals in which the criteria for assigning an exposure to qualified rolling exposures are set forth.

State in particular to what extent the institution considers the non-utilised portion of a retail exposure that is qualified and rolling to be unconditional and immediately cancellable. State the manner in which consumer protection legislation will be applied in practice.

Append an analysis that shows that the exposures classified as qualified rolling retail exposures meet the requirements regarding volatility in loss levels. The analysis should be broken down by product or using other similar breakdown.

7. From FFFS 2007:1 Chapter 37, section 6:

“The exposure class "equity exposures" is assigned the following exposures:

- 1. Exposures recorded as equity by the issuer conveying a subordinated, residual claim on the assets or income of the issuer.*
- 2. Exposures recorded as debt in the issuing institution but that have properties and conditions that result in similar economic implications as exposures specified in point 1.”*

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution’s reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as an equity exposure. Refer in the reply to the sections in appended policy documents or manuals in which the criteria for assigning an exposure to equity exposures are set forth.

The institution shall in particular state how exposures are identified in accordance with the second point and state their volume.

8. From FFFS 2007:1 Chapter 37, section 7:

“Assets which do not entail that performance is required from any counterparty are assigned to the exposure class non credit-obligation assets.

If the institution leases assets and the leasing agreement is designed such that the institution carries the financial risk associated with the assets, the residual value is assigned to this exposure class.”

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution’s reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as a non-credit obligation asset. Refer in the reply to the sections in appended policy documents or manuals in which the criteria for assigning an exposure to a non credit-obligation asset are set forth.

9. From FFFS 2007:1 Chapter 37, section 8:

“Securitisation positions are assigned to securitisation positions exposure class.

Securitisation positions also refer to exposures arising from interest rate or currency derivative contracts included in the structure of the securitisation.

Institutions which provide credit protection for positions in a securitisation are considered to have a direct position in the securitisation.”

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution’s reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as an exposure to securitisation positions. Refer in the reply to the sections in appended policy documents or manuals in which the criteria for assigning an exposure to securitisation positions are set forth.

10. From FFFS 2007:1 Chapter 37, section 9:

“Any exposures not assigned to any of the other exposure classes shall be assigned to the corporate exposure class.”

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution’s reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as an exposure to corporates. Refer in the reply to the sections in appended policy documents or manuals in which the criteria for assigning an exposure to exposures to corporates are set forth.

11. From FFFS 2007:1 Chapter 37, section 10:

“Within corporate exposures, specialised lending exposures shall be distinguished. Specialised lending refers to exposures that have all of the following characteristics:

- 1. The exposure is to a legal entity created specifically to finance or manage physical assets.*
- 2. The contractual arrangements give the lender a substantial degree of control over the assets and the income they generate.*
- 3. The primary source of repayment of the obligation is the income generated by the financed assets.”*

State the manner in which the institution assigns exposures to this exposure class:

Instructions for how the institution’s reply should be formulated:

The institution shall state the criteria that govern the classification of an exposure as specialised lending. Refer in the reply to the sections in appended policy documents or manuals in which the criteria for assigning an exposure to specialised lending are set forth. The description shall state the manner in which the identification of such exposures takes place in practice.

State in particular the factors that are taken into account when establishing if there is a substantial degree of control in accordance with the second point. Also state the volume that is considered specialised lending. The institution shall state the share and number of the total portfolio that consists of specialised lending (if this is not shown in table 2 and/or 3). State for both counterparties and exposure volumes.

Does not apply if Chapter 38, section 4 is applied**12. From FFFS 2007:1 Chapter 38, section 2:**

“Risk-weighted exposure amounts and expected loss amounts shall be calculated for dilution risk of purchased retail and corporate receivables.

Risk-weighted exposure amount and expected loss amounts for dilution risk are determined by the risk parameters exposure amount, PD and LGD. The risk-weighted exposure amount is also affected by the parameter maturity (M).

Institutions that can evidence negligible dilution risk in its purchased receivables do not need to calculate any risk-weighted exposure amount for dilution risk.”

State the institution’s purchased receivables and if the dilution risk is considered to be negligible.

Instructions for how the institution’s reply should be formulated:

Institutions that have purchased receivables calculated in accordance with this section shall show in appended documents how these receivables are identified and state their volumes.

If the institution considers the dilution risk to be negligible, the institution shall refer to relevant, appended documents that show this.

Does not apply if Chapter 38, section 4 is applied

13. From FFFS 2007:1 Chapter 38, section 3:

“The institution shall fulfil the operational requirements in Chapter 46, sections 1-5 for all purchased receivables.”

State how the institution complies with the section.

Instructions for how the institution’s reply should be formulated:

The institution shall describe in general how and certify that it complies with the operational requirements in Chapter 46, sections 1-5.

14. From FFFS 2007:1 Chapter 38, section 4:

“A group of purchased receivables may be treated as an exposure to the seller secured by the purchased receivables if the following requirements are met:

- 1. the institution shall have recourse that addresses credit risk and dilution risk in the purchased receivables, and*
- 2. the requirements for receivables set out in Chapter 54, sections 6 and 10 shall be met.*

An institution which treats purchased receivables in accordance with the first paragraph is not required to apply the provisions set out in sections 2-3.”

State if the institution intends to apply the section and how the institution complies with it. Refer to relevant appended documents:

Instructions for how the institution’s reply should be formulated:

The institution shall state if it has exposures that are expected to be handled in accordance with the section and their volume. The institution shall also certify that it complies with the established requirements.

15. From FFFS 2007:1 Chapter 38, section 7:

“For eligible purchased corporate receivables, the institution may apply the rules for rating systems and estimating risk parameters that apply for retail exposures. Purchased corporate receivables are eligible provided the following requirements are met:

- Treating the purchased receivables in the same way as other corporate exposures shall be associated with great difficulty.*
- The institution shall have purchased the receivables from an unrelated third-party seller and the purchased receivables may not directly or indirectly originate from the institution.*
- The purchased receivables must have originated at market rates.*
- The receivables may not be intra-group account receivables or receivables subject to contra-accounts between firms that buy and sell receivables from and to one another.*
- The institution shall have a claim on all proceeds from the purchased receivables or a proportional share of the proceeds.*
- The portfolio of purchased receivables shall be well diversified.”*

State if the institution intends to use the section and how the institution complies with the requirements:

Instructions for how the institution’s reply should be formulated:

Institutions intending to use the section shall:

- Show that they comply with the first and last requirements by appending and referring to relevant documentation.
- Certify that they comply with the remaining requirements.

16. From FFFS 2007:1 Chapter 38, section 9:

“The risk-weighted exposure amount for equity exposures shall be calculated by one of the approaches specified in Chapter 39, sections 16-23. The risk-weighted exposure amount for equity exposures to ancillary services undertakings that are included in the financial group may be calculated in accordance with the rules for non credit-obligation assets.

Institutions may obtain permission to calculate risk-weighted exposure amounts in accordance with Chapter 39, section 23. Institutions must meet the requirements in Chapter 45 in order to receive such permission.

An institution may use different approaches for different portfolios of shareholdings if the following requirements are met:

- 1. the institution shall internally apply different approaches to different equity portfolios,*
- 2. the choice of approaches for calculating capital requirements may not be influenced by the desire of the institution to receive a lower capital requirement,*
- 3. the approaches that the institution wishes to apply to calculate capital requirements shall be used consistently.”*

State how the institution intends to comply with the section.

Instructions for how the institution’s reply should be formulated:

The institution shall state which method it intends to use for the equity exposures given that the institution does not fulfil the requirements in Chapter 38, section 18, first paragraph. The institution shall state the volume of these equity exposures and how large a portion of them the institution is applying for permission for in accordance with Chapter 38, section 18, second paragraph.

Institutions intending to use different approaches in accordance with the last paragraph shall append an account of how the institution complies with the requirements as well as show that it uses the approaches consistently across the different portfolios.

Equity exposures that shall be handled under the PD/LGD approach have the same requirements as exposures to corporates. Institutions shall thereby answer the same questions that refer to sections concerning exposures to corporates.

Institutions intending to apply for permission to use internal approaches will receive questions in addition to this application.

17. From FFFS 2007:1 Chapter 38, section 10-12:

State the size of the institution's CIU holding and other exposures to CIUs and the portion for which the institution uses the approach in Chapter 38, sections 10, 11 and 12 to calculate capital requirements:

Instructions for how the institution's reply should be formulated:

The institution shall state all exposures to CIUs, including, for example, derivative exposures.

18. From FFFS 2007:1 Chapter 38, section 15:

“The institution may receive permission to calculate risk-weighted exposure amounts for exposures to the Swedish government, the Swedish Central Bank and Swedish local authorities in accordance with the standardised approach for credit risks.”

State if the institution intends to apply for permission in accordance with the section:

19. From FFFS 2007:1 Chapter 38, section 16:

“The institution may calculate risk-weighted exposure amounts for exposures to a subsidiary, a parent undertaking or a subsidiary of its parent undertaking in accordance with the standardised approach for credit risks provided that the counterparty is an institution, a financial holding company, financial institution, asset management company, ancillary services undertaking or an equivalent foreign undertaking.”

State if and to what extent each institution in the financial group uses the section:

20. From FFFS 2007:1 Chapter 38, section 18, first paragraph:

“The institution may calculate the capital requirement for all equity exposures in accordance with the standardised approach for credit risks if the aggregate value of the equity exposures is less than 10% of the institution's own funds, calculated as an average over the past year. If the number of equity exposures is less than 10 individual holdings, the threshold shall be 5% of the institutions' own funds. Such equity exposures that apply to companies as referred to in section 16 as well as equity exposures referred to in section 17 may be excluded from the calculation of the aggregate value.”

State if the institution uses the paragraph and, if yes, if the threshold value is met:

Instructions for how the institution's reply should be formulated:

If the exception is utilised, provide for each subsidiary, which is an institution, in the financial group an analysis that shows that the threshold value is met.

21. From FFFS 2007:1 Chapter 38, section 18, second paragraph:

“In conjunction with the application for permission to use the IRB approach, the institution may obtain permission to exclude, until 31 December 2017, equity exposures that the institution holds on 31 December 2007 from the IRB approach in addition to what is set out in the first paragraph.”

State if the institution will apply for permission in accordance with the section:

Instructions for how the institution’s reply should be formulated:

It is requested that the institution reports if it intends to apply for permission. The institution shall state which exposures this applies to and in which subsidiary they are located.

22. From FFFS 2007:1 Chapter 38, section 19:

“The institution may be permitted to phase in the IRB approach or own estimates of conversion factors and LGD per exposure class and in respect of retail exposures per sub-group of exposures or business line. A gradual implementation may take place over a period not exceeding three years from the date on which the institution was granted permission. This section shall not apply to equity exposures. Permission may only be granted where the following conditions are met:

- 1. The institution applies the IRB approach for at least 30% of the total exposure amount at the group level calculated in accordance with Chapter 40.*
- 2. The institution can demonstrate that the determinative factor for the manner in which implementation is taking place is the institution's ability to comply with minimum requirements and not the manner which results in the lowest capital requirement.*
- 3. The institution has submitted to Finansinspektionen a realistic timetable regarding implementation of the IRB approach or own estimates of conversion factors and LGD.”*

State if the institution will apply for permission in accordance with the first paragraph of the section: State how the conditions are met:

Instructions for how the institution's reply should be formulated:

The institution shall append a calculation in accordance with the first point in the section. Refer to the flysheet where relevant.

It is requested that the institution describe its implementation plan for the IRB approach. The institution shall give reasons for the order in which the implementation shall take place in accordance with the requirement set out in the second point and show why it is reasonable to believe that that the implementation plan will be followed. In accordance with the requirements in the third point, an implementation plan for each sub-portfolio shall present a timetable, a brief description of the process and commenced work.

Institutions shall append and refer to the requisite plan in accordance with the third point. Finansinspektionen's assessment of whether the plan is realistic may also be facilitated if other relevant documentation is appended, for example decisions regarding budgets/allocation of resources.

23. From FFFS 2007:1 Chapter 38, section 20:

“The institution may be granted a time-limited permission to apply the standardised approach for credit risks for portfolios of insignificant size. This provision does not apply to equity exposures. Permission may only be granted under the following conditions:

- 1. The total risk-weighted exposure amount for the exposures for which the longer implementation period is used is less than 15% of the total risk-weighted exposure amount on a group basis calculated in accordance with the standardised approach for credit risks.*
- 2. It would be unreasonably burdensome for the institution to implement the IRB approach or own estimates of conversion factors and LGD for the exposures in question within the prescribed three-year period.*

Upon expiry of the permission the institution may apply for a new time-limited permission to use the standardised approach for credit risks. Permission may be granted provided the above conditions are met.”

State if the institution will apply for permission in accordance with the section. State the manner in which the conditions are met. Refer to appended, relevant documentation, if any:

24. From FFFS 2007:1 Chapter 38, section 21:

“The institution may be permitted to apply the standardised approach for credit risks for the exposure classes, exposures to governments or exposures to institutions provided the following conditions are met:

- 1. The exposure class or classes for which the standardised approach for credit risks is used in accordance with this section do not represent the greater part of the institution's total exposure.*
- 2. The number of material counterparties within the exposure class is limited.*
- 3. It would be unreasonably burdensome for the institution to implement the IRB approach for the exposure class.”*

State if the institution will apply for permission in accordance with the section. State the manner in which the conditions are met. Refer to appended, relevant documentation, if any:

Instructions for how the institution's reply should be formulated:

If the institution is applying for permission, attach documents with the following information concerning the exposure class(es):

- State the number of counterparties and volume in SEK in each exposure class. Also state the manner in which many of the counterparties are judged to be insignificant and an explanation for this judgement. Include guarantees and guarantors if the institution takes these into consideration during the calculation of the capital requirement (also applies to credit derivatives).
- Explain why it is unreasonably burdensome to implement the IRB approach for the exposure class(es).

25. From FFFS 2007:1 Chapter 38, section 22:

“The institution may be permitted to continue to apply the standardised approach for credit risks for exposures to institutions that the institution has as a consequence of requirements on minimum reserves from the ECB or from a member state's central bank. In addition, the following requirements must be met:

- 1. Reserves held in compliance with Regulation (EC) No 1745/2003 of the European Central Bank of 12 September 2003 on the application of minimum reserves (or a later amending regulation, or in compliance with a national regulation which is equivalent in all material respects.*
- 2. In the event of bankruptcy or insolvency in the institution in which the reserves are kept, the reserves may not be used to cover the institution's other commitments. It shall be possible to repay the reserves in full without delay.”*

State if the institution will apply for permission in accordance with the section. State the manner in which the requirements are met. Refer to appended, relevant documentation, if any:

26. From FFFS 2007:1 Chapter 39, section 3:

“Within the exposure class exposures to corporates the following correlation function may be used when calculating the risk-weighted exposure amount for exposures to companies with sales of less than EUR 50 million:

$$R = 0.12 * (1 - \text{EXP}(-50 * PD)) / (1 - \text{EXP}(-50)) + 0.24 * [1 - (1 - \text{EXP}(-50 * PD)) / (1 - \text{EXP}(-50))] - 0.04 * (1 - (S-5)/45)$$

In this formula, the parameter S denotes the company's total sales in accordance with the most recently adopted and available annual accounts, expressed in EUR million, if S lies within the range 5-50. Where total sales are less than EUR 5 million, the constant S = 5 is used. For a pool of purchased receivables, the total sales shall be calculated as an exposure weighted average of the individual exposures of the pool.

Where the counterparty firm is included in a group, the group's aggregate sales shall be used as a measure of size.

When total sales are not a meaningful indicator of size, total assets shall be used if this measure is a more meaningful indicator.”

State if and when total assets shall be used as an indicator. Refer to appended, relevant documentation, if any:

27. From FFFS 2007:1 Chapter 39, section 5, first, second and third paragraphs:

“For non-defaulted exposures to corporates constituting specialised lending, institutions that cannot demonstrate that their PD estimates meet the requirements set out in Chapters 41 and 44 shall calculate the risk weights as follows.

Institutions shall assign specialised lending exposures to corporates to five categories. Categories 1-4 shall refer to non-defaulted exposures and category 5 to defaulted exposures. Assignment to categories 1-4 shall be based on the increasing risk level of the exposures. The institution shall have policy documents, systems and procedures to consistently assign the exposures.

The institution's criteria for categories 1-4 shall consider the following factors:

- 1. financial strength,*
- 2. political and legal factors,*
- 3. distinctive characteristics of transactions and/or assets,*
- 4. strength of the sponsor and developer, including any public and private partnership income stream, and*
- 5. collateral.”*

State if this section will be used and the manner in which it is complied with. Refer to appended, relevant documentation, if any:

Instructions for how the institution's reply should be formulated:

The institution shall state if exposures to corporates that are considered to be specialised lending will be assigned to a risk grade in accordance with the institution's IRB approach or if this section will be applied. Explain the reasons for this decision.

If the IRB approach is used, the following shall be included in the explanation:

The institution shall show the system's ability to differentiate risk between specialised lending exposures by appending the following:

- A scatter plot of the counterparties in each risk grade.
- A compilation of default rates of specialised lending per risk grade
- A statistical test of the differentiation capacity, Lorentz curve or equivalent

The institution shall state if it takes into account criteria other than for exposures to corporates when assigning specialised lending to risk grades.

28. From FFFS 2007:1 Chapter 39, section 5, final paragraph:

“The institution may be granted permission for maturities of 2.5 years or more to assign risk weights of 50% and 70% for categories 1 and 2, respectively. For such permission to be granted, the institution must be able to verify that underwriting characteristics and other risk characteristics are substantially strong for the relevant category.”

State if the institution will apply for permission in accordance with the section and the manner in which the institution meets the conditions for permission. Refer to appended, relevant documentation:

Instructions for how the institution’s reply should be formulated:

This question is only relevant if the institution intends to apply Chapter 39, section 5.

Only applies to institutions intending to use the PD/LGD approach for equity exposures.

29. From FFFS 2007:1 Chapter 39, section 20:

“An institution that does not have sufficient information to apply the definition of default set out in Chapter 41, sections 7-10, shall multiply the risk-weighted exposure amount by 1.5.”

State if the institution applies this section and explain:

Note that the following sections from Chapter 40 are only relevant for retail portfolios in cases where the institution is not applying for permission in accordance with Chapter 38, section 6.

30. From FFFS 2007:1 Chapter 40, section 34:

“The institution shall grade its exposures, i.e. divide them into different grades. The institution can choose between making a product grading or risk grading. When carrying out product grading, the exposures are divided up into gradings which shall contain products of similar structures and conditions. When carrying out risk grading, the grades shall show homogeneity from a risk perspective. An institution carrying out grading shall meet all the requirements that apply to risk grading and estimation of PD and LGD with the exception of the requirements set out in Chapter 44, sections 15-17.

With respect to retail exposures, the institution may elect to use a pooling of the exposures which reflects the risk in conversion factor as well as PD and LGD instead of a separate grading for each risk parameter. Such a pooling shall capture obligor as well as transaction-specific factors.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall state which method of classification it intends to use. The documentation shall show if the institution groups retail exposures in accordance with the second paragraph.

Institutions intending to use product grading shall describe the products, the manner in which they are classified and the criteria for the classification. Append the distribution of the exposures across the product ratings.

Institutions intending to use risk grading shall briefly describe each stage of the rating system for the conversion factor. The institution shall also append and refer to all documents that describe its methods and processes for assigning exposures to risk grades in accordance with the conversion factor dimension. Documents that should be referred to include:

- Methodology documents, including a description of the approach used in conjunction with method development.
- Instructions and other policy documents governing the manner in which assignments of grades shall occur.

Note that we are interested here in the actual grade – not the estimate – of conversion factor. However, we understand that it can at times be difficult to distinguish between the grade and the estimate.

Append the distribution of exposures to conversion factor grades. The institution shall also append a quantitative analysis of the homogeneity of the grades with regard to the conversion factor.

As a part of the homogeneity analysis, the institution shall describe the explanatory variables or segment criteria which have been selected or rejected for the assignment into risk grades and the reasons for the selection of variables/criteria.

31. From FFFS 2007:1 Chapter 40, section 35:

“All exposures shall be product graded or risk graded.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to the sections in the appended policy document in which it is set out that all exposures shall be assigned a product or risk grading in the conversion factor dimension.

32. From FFFS 2007:1 Chapter 40, section 36:

“The number of exposures in each product grade or risk grade shall be sufficiently large to allow for meaningful quantification and validation of the conversion factor.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append the distribution of the exposures into the product grades or conversion factor risk grades.

33. From FFFS 2007:1 Chapter 40, section 37:

“The institution shall calculate an estimation of a conversion factor by product grade or risk grade on the basis of the average realised conversion factor per grade.

However, an institution that treats retail exposures in accordance with section 34, second paragraph, may reflect future drawings of credit facilities or in their LGD estimates.

All defaults during the observation period shall be used in the calculations.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append and refer to all documents that describe the institution’s approach for estimating the conversion factor for each product grade or risk grade. The institution shall in particular justify its choice of estimation method.

If the institution has chosen to take into account the risk of additional drawings of credit facilities in its LGD estimate, it shall also describe separately the manner in which this was done.

The institution shall append an analysis that identifies if any of the defaults in the historical data are missing/excluded and the effect this will have on the estimate.

34. From FFFS 2007:1 Chapter 40, section 38:

“Where the value of the conversion factor during periods of economic downturn is higher than the average conversion factors, the conversion factor shall be estimated on the basis of these higher values. The institution shall analyse and be able to report a difference between these and the average conversion factors.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append an analysis of the manner in which the conversion factor varies depending on the financial circumstances and the manner in which the institution has taken this into account in its estimate.

35. From FFFS 2007:1 Chapter 40, section 39:

“Institutions' estimates of conversion factors shall reflect the possibility of additional drawings by the obligor up to and after the time of default. When conversion factors are estimated, institutions shall consider their internal policies and strategies in respect of monitoring credit facilities and payment processing. Institutions shall also consider their ability and willingness to prevent further drawings of credit facilities by the obligor shortly before the default.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Describe the manner in which the requirement in the first sentence of the section is met. In addition, append an analysis of the manner in which internal control principles and procedures affect the conversion factor.

36. From FFFS 2007:1 Chapter 40, section 41:

“Institutions shall have satisfactory systems and procedures in place to on a daily basis monitor facility amounts, current drawn amounts of the facilities and changes in drawn amounts per obligor and per grade.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which the requirement concerning secure systems and procedures is met. Append policy documents, manuals or equivalent documentation that govern follow-up of facility amounts and current drawn amounts and that state the manner in which and where in the institution the procedures shall be carried out in practice. The appended documents should also contain a general description of the IT support that is available.

37. From FFFS 2007:1 Chapter 40, section 42:

“The institution shall use the same definition of default for estimation of conversion factors as for estimation of PD.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer in an appended data quality analysis to relevant sections that refer to the data quality reviews the institution has conducted regarding the definition of default.

38. From FFFS 2007:1 Chapter 40, section 43:

“With respect to retail exposures the estimates shall be based on data over a minimum of five years. If relevant data prior to the five-year requirement is available, the estimates shall also be based on this data. However, institutions need not accord equal weight to historic data if it can demonstrate that, as regards conversion factors, the more recent data has greater predictive power than historic data.

For retail exposure, the institution can, during a transition period, be granted permission to base its estimates for conversion factors on less than five years' data. However, the estimates must be based on at least two years' data. The data on which the estimates are based must be updated with at least one year of new data for each year that passes after permission was granted. Permission to derogate from the requirement of five years' data is conditional on the institution having a safety margin in its estimates which compensates for the uncertainty resulting from the lack of data.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation. State if the institution will apply for permission in accordance with the second paragraph and the manner in which the institution meets the conditions for permission:

Instructions for how the institution's reply should be formulated:

Refer to where in the appended methodology documentation it is stated that the requirement is met. If the institution has chosen to weight the data, an analysis that supports this decision shall be appended.

The institution can apply for permission to base the estimate on less than five years of data in accordance with the second paragraph. In such a case, the institution shall specifically state that it will apply for this permission and show the manner in which it meets the requirements to receive permission, i.e. that the estimate contains the safety margin that is a prerequisite for receiving permission.

Only applies to institutions applying for permission in accordance with Chapter 38, section 6.

39. From FFFS 2007:1 Chapter 40, section 44:

“With respect to exposures to institutions, governments and corporates, own estimates of conversion factors shall be based on data over a minimum of seven years from at least one of the data sources. However, from the time the institution is permitted to use the IRB approach the estimates may be based on five years' of data. The institution shall thereafter gradually base the estimate on data from an increasingly longer period of time until the requirement for seven years of data is met. If relevant data prior to the seven-year requirement is available , estimates shall also be based on this data.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Refer to where in the appended methodology documentation it is stated that the requirement is met.

40. From FFFS 2006:1 Chapter 41, section 1:

“The institution shall have an internal rating system containing at least one rating scale which exclusively reflects the risk of default.

With respect to retail exposures, institutions may elect to use a pooling of exposures which reflects risk in LGD as well as PD and conversion factors, instead of a separate grade for each risk parameter. Such a pooling shall capture obligor as well as transaction-specific factors.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall briefly describe the different parts/elements of its rating system(s) for PD. The institution shall also append and refer to all documents that describe the institution’s methods and processes for assigning its exposures to risk grades in accordance with the PD dimension. Documents that should be appended include:

- Methodology documents, including a description of the approach used in conjunction with method development.
- Instructions and other policy documents that govern the manner in which assignment to grades shall occur.

The documentation shall state if the institution groups retail exposures in accordance with the second paragraph.

Describe which rating philosophy is used: Through The Cycle (TTC) or Point In Time (PIT).

Note that, in this context, we are interested in the actual rating – not the estimate – of the PD. However, we understand that it can at times be difficult to distinguish between the grade and the estimate.

41. From FFFS 2006:1 Chapter 41, section 2, first paragraph:

“Each obligor or exposure shall be assigned to a risk grade.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to the sections in the appended policy document in which it is stated that all exposures shall be rated in the PD dimension.

42. From FFFS 2006:1 Chapter 41, section 2, second paragraph:

“The risk grades shall be assigned by counterparty. Each separate legal entity shall be separately rated. With respect to retail exposures, the grade may be assigned by exposure.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State where in the policy documents it is set out that all legal persons are risk graded separately and that the grades are not only based on Group affiliation.

For retail exposures, the institution shall state if the risk grade is assigned per obligor or exposure or if both alternatives are used in different parts of the institution.

43. From FFFS 2006:1 Chapter 41, section 3:

“The risk differentiation between grades shall be appropriate. The exposures or counterparties in each grade shall demonstrate sufficient homogeneity from a risk perspective. Distribution across grades shall be such as to avoid excessive concentrations of exposures or counterparties within a few grades in the absence of any convincing empirical support for such concentrations. However, the number of exposures or obligors in each grade shall be sufficient to allow for meaningful quantification and validation of the default risk. Risk differentiation shall be sufficient within each separate significant business line.

With respect to exposures to governments, institutions, corporates and equity exposures, the obligor rating scale shall have a minimum of seven grades for non-defaulted obligors and at least one for defaulted obligors.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall append the distribution of the exposures into PD risk grades. The distribution shall state the volume and the number of counterparties per risk grade.

The institution shall also append a quantitative analysis of the homogeneity within and differentiation between the grades with respect to PD. As a part of the homogeneity and differentiation analysis, the institution shall describe the explanatory variables or segment criteria which have been selected or rejected for the division into risk grades and the reasons for the selection of variables/criteria.

If there is a large number of concentrations in one or several grades, the institution shall append empirical support for such concentrations.

44. From FFFS 2006:1 Chapter 41, section 4:

“With respect to retail exposures, the counterparties' performance on their obligations to the institution shall affect their grade unless the institution demonstrates that delinquency is not a material driver of risk for the exposure.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Refer to where in the appended methodology documentation it is stated that the requirement is met.

If the institution has chosen not to include the payment history as an explanatory variable with respect to PD for retail exposures, the institution shall append an analysis demonstrating that payment history is irrelevant to the risk of default.

45. From FFFS 2006:1 Chapter 41, section 7:

“An exposure to a certain counterparty shall be deemed defaulted where any of the following criteria are met:

- 1. The institution considers that it is likely that the obligor will not be able to meet its obligations to the institution without the institution being forced to realise a security or any similar measures.*
- 2. The obligor is past due more than 90 days on any material credit obligation to the institution.*

The following events shall be seen as strong indications that default has occurred:

- 1. the institution begins to treat the exposure in accordance with its criteria for bad claims, e.g. it places the credit obligation on non-accrued status,*
- 2. the institution makes a provision or write-off for the claim due to a decline in the counterparty's creditworthiness,*
- 3. the institution sells the claim at a material loss, which wholly or partly reflects a projected credit loss,*
- 4. the institution consents to a restructuring of the counterparty's liabilities which are likely to result in a diminished financial obligation caused by the material reduction, or postponement, of payments by the counterparty, or where*
- 5. the institution has filed for the counterparty's bankruptcy or a similar order or the counterparty has sought bankruptcy on its own accord.*

The institution shall be able to justify why it has chosen to disregard such events when assessing whether a default has occurred.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

State the institution's definition of default. Refer in particular to the manner in which the indications in the second paragraph are taken into account. Append policy documents on the manner in which defaults are registered.

Describe the manner in which the institution has ensured that the definition used in the historical data is in agreement with the institution's current definition of default. Refer to relevant sections in the appended data quality analysis.

46. From FFFS 2006:1 Chapter 41, section 8, first paragraph:

“If the counterparty is located in an EEA country, when applying section 7, first paragraph, point 2 in relation to retail exposures and exposures to publicly-owned organisations, an institution may rely on the period of time which the competent authorities in the country in question have decided upon for the purpose. However, this period of time may never exceed 180 days. This exception shall also apply with respect to exposures to corporates up to and including 31 December 2011.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State if the institution is utilising the possibility to use a period longer than 90 days and in respect of which exposures. Refer to appended policy documents. State the source of the institution’s information regarding the regulations in the country in question.

47. From FFFS 2006:1 Chapter 41, section 8, third paragraph:

“The institution shall document all cases in which a counterparty has been more than 90 days late with a payment but where the delay was not registered as a default due to the fact that the transaction referred to an insignificant amount.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State to what extent the institution uses the negligibility concept. Append a general summary of documented cases. Append the criteria that define what shall be classified as negligible.

48. From FFFS 2006:1 Chapter 41, section 9:

“If any exposure to a particular counterparty is in default, then all of the institution’s exposures to the same counterparty shall be deemed defaulted. The aforesaid shall apply to exposures of another institution in the same financial group to such counterparty. An institution which has chosen to assign its exposures in the retail portfolio to grades per exposure and not per counterparty shall, however, make individual default assessments regarding such exposures.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Explain the manner in which the institution has ensured that all exposures to one counterparty within the entire financial group are jointly checked. This does not apply to retail exposures.

49. From FFFS 2006:1 Chapter 41, section 10:

“A counterparty or exposure that has been default graded but no longer meets the definition of default shall be rated and treated as other non-defaulted exposures. This also implies that, should the same counterparty or exposure go into default again, it should be treated as a new default.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State the criteria applicable for an exposure to be re-classified from default status. Append the instructions and procedures that apply to follow-ups that default exposures are re-classified.

50. From FFFS 2006:1 Chapter 41, section 11:

“Institutions shall estimate PDs by grade from long run averages of default per grade and year. To the extent that an institution uses statistical default prediction models it is allowed to estimate PDs for the grade as the unweighted average of individual PD estimates in a given grade.

An institution which treats retail exposures in accordance with section 1, second paragraph may calculate the PD estimates for retail exposures based on realised losses and the institution's estimate of LGD.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Append all documents that describe the institution's method for estimating PD for each risk grade. The documentation shall state which reference time is used to determine which the grade in which the default is included and the reasons for this choice.

In particular, the institution shall state the reasons for its choice of method for estimates and if it is utilising the possibility in the second paragraph regarding retail exposures.

The institution shall refer to appended data quality analysis. The analysis shall explain if any parts of the historical data are missing/excluded and the effect thereof on the estimate.

Does not apply if Chapter 38, section 4 is applied**51. From FFFS 2006:1 Chapter 41, section 12:**

“For eligible purchased corporate receivables the institution may determine PD in accordance with the following methods.

The institution shall calculate an estimate of EL from long-run averages of realised losses for each block of purchased receivables. PD is calculated by dividing EL by LGD.

An institution that does not have permission to use own estimates of LGD shall use the following values for LGD. If the purchased group of receivables exclusively consists of receivables without subordination, LGD shall be assumed to be 45%. For other groups of purchased receivables LGD shall be 100%, i.e. PD shall equal EL.

An institution that has permission to use own estimates of LGD shall use these when PD is determined in accordance with the second paragraph.”

State if the institution intends to use this section as well as its compliance with the section; refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall state if it uses this section for any exposures and, if it does, submit/append a description of its approach.

If the institution estimates own LGD, it shall state which LGD approach it uses and, if a specific method is used for these exposures, append comprehensive documentation of the approach under relevant questions pertaining to LGD.

52. From FFFS 2007:1 Chapter 41, section 14:

“For the retail exposures class the institution shall analyse whether certain types of exposures can be expected to have a substantially higher default frequency during a part of the exposure's life cycle for which the institution still lacks data. The institution shall consider these possible effects in the PD estimate for these exposures and counterparties.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Append the institution's analyses of the stated phenomenon. State whether, and if so how, the institution has taken this into account in the PD estimate for certain exposures.

53. From FFFS 2007:1 Chapter 41, sections 15 and 16:

“The PD estimate shall be based on data over a minimum of five years. Where earlier data is available and relevant, such data shall also be used. With respect to retail exposures, however, an institution may give less importance to historic data if it can demonstrate that results in a better predictor of default.”

“With respect to retail exposures, in connection with an application for permission to use the IRB approach, the institution may be permitted to base the estimates of PD on less than five years of data under the conditions given in the second paragraph. The aforesaid shall also apply to exposures to institutions, governments and corporates where the institution does not use own estimates of conversion factors and LGD for such exposures. However, for all exposure classes, the PD estimates must be based on at least two years' data. The data on which the estimates are based must be updated with at least one year of new data for each year that passes after permission was granted. Derogation from the requirement of five years' data is conditional on the institution having a safety margin in its estimates which compensates for the uncertainty resulting from the lack of data.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation. State if the institution will apply for permission in accordance with section 16 and the manner in which the institution meets the conditions for permission:

Instructions for how the institution's reply should be formulated:

Refer to where in the appended methodology documentation it is stated that the requirements are met. If the institution has chosen to weight the data, an analysis supporting this decision should be appended. Refer to relevant sections of the methodology documentation.

The institution may apply for permission to base an estimate on less than five years of data in accordance with section 16. In such a case, the institution shall specifically state that it will apply for this permission and demonstrate the manner in which it meets the conditions for the granting of permission, i.e. that the estimate contains a safety margin which is a prerequisite for permission.

54. From FFFS 2007:1 Chapter 41, section 17:

“With respect to exposures to governments, institutions and corporates and equity exposures, the institution may map its internal grades to an external rating institution's ratings and attribute the default rate observed from the external rating institution's rating classes as the basis for the institution's own PD estimates, provided the following conditions are met:

- 1. The external rating institution's methodology must only reflect the default risk among the counterparties.*
- 2. The institution shall compare the classification criteria applied by the institution internally and the external rating institution's rating criteria as well as conduct an analysis of the significance of any differences with respect to default frequency.*
- 3. The institution shall compare how the institution and the external rating institution rate the same counterparties.*
- 4. The institution shall analyse any differences in the definitions of default between these provisions and the definition used by the external rating institution as well as the significance of any differences with respect to the default frequency.*
- 5. The above conditions have been documented.”*

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

State if the institution uses the method described in the section. If so, append the analysis which shall be conducted in accordance with the section.

Does not apply if Chapter 38, section 4 is applied

55. From FFFS 2007:1 Chapter 41, section 18:

“Institutions which cannot estimate PD for dilution risk in purchased retail and corporate receivables may be permitted to determine PD by estimating EL for the dilution risk. PD shall be equal to this estimate of EL.”

State if the institution uses this section and the manner in which the institution complies with the section. Refer to relevant, appended documents:

Instructions for how the institution’s reply should be formulated:

State whether the institution uses the method described in the section and with respect to which exposures.

Append documentation describing the institution’s approach for estimating EL.

56. From FFFS 2007:1 Chapter 41, section 19:

“With respect to the exposures for which the institution is not permitted to calculate own estimates of LGD and conversion factors, the institution may take into consideration the effects of guarantees, credit derivatives, life insurances and cash on deposit with another institution on its PD estimates in accordance with that set out in Chapters 53 and 57.

When PD is adjusted to take into account credit protection in accordance with the first paragraph, the risk-weighted exposure amount for the protected portion of the underlying exposure is calculated with the formula set out in Chapter 39 for the exposure class to which the issuer of the guarantee or credit derivative belongs.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State the portion of the portfolio broken down by current exposure class for which PD has been adjusted for guarantees in accordance with this section. Describe the breakdown of PD classes before and after the effect of guarantees.

57. From FFFS 2007:1 Chapter 41, section 20:

“With respect to the exposures for which the institution is permitted to calculate own estimates of LGD and conversion factors, the institution may take into consideration the effects of guarantees and credit derivatives in its PD estimates in accordance with that set out below.

Where there is a valid guarantee or credit derivative in accordance with Chapter 42, sections 23-27 for an exposure, PD may be adjusted to take this into account. However, the adjustment may not result in a lower risk weight for the protected exposure than would have been the case for an exposure directly to the issuer of the protection. The provisions set out in Chapter 42 with respect to the adjustment of LGD also apply to the adjustment of PD.

When PD is adjusted to take into account a guarantee or credit derivative, the risk-weighted exposure amount for the protected portion of the underlying exposure is calculated with the formula set out in Chapter 39 for the exposure class to which the issuer of the guarantee or credit derivative belongs.”

Instructions for how the institution’s reply should be formulated:

Where the institution issues own estimates of LGD, it may choose if it will take into account the effect of guarantees and credit derivatives in PD, LGD or both (but without falling below the stated floor). Regardless whether the institution has chosen to adjust PD or LGD, information thereon shall be appended in accordance with Chapter 42.

Note that the following sections in Chapter 42 are only relevant for retail portfolios in cases where the institution does not apply for permission in accordance with Chapter 38, section 6.

58. From FFFS 2007:1 Chapter 42, section 10:

“The institution shall have an internal rating system with a grading of exposures that exclusively reflects LGD.

With respect to retail exposures, the institution may elect to use a pooling of the exposures which reflects the risk in LGD as well as a PD and conversion factor, instead of a separate grade for each risk parameter. Such a pooling shall capture obligor as well as transaction-specific factors.

An exposure may be divided into two or more parts which are rated separately, for example one part with collateral and one without.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall briefly describe the different parts/elements in its LGD rating system. The institution shall also append and refer to all documents that describe its method and process for assigning its exposures to grades in accordance with the LGD dimension. Documents that should be appended include:

- Methodology documents, including a description of the approach used in conjunction with method development.
- Instructions and other policy documents governing the manner in which assignment of grades shall occur.

Clarify if grouping as set out in section 10, second paragraph is applied. Also describe the manner in which this grouping is done and refer to relevant documentation.

If exposures are divided in accordance with section 10, third paragraph, references thereto in manuals or instructions shall also be made.

59. From FFFS 2007:1 Chapter 42, section 11:

“All exposures shall be assigned to a risk grade.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Refer to the section in the appended policy document in which it is set out that all exposures shall be rated in the LGD dimension.

60. From FFFS 2007:1 Chapter 42, section 12:

“The exposures in each grade shall exhibit sufficient homogeneity from a risk perspective. Distribution across grades shall be such as to avoid excessive concentrations of exposures within a few grades in the absence of any convincing empirical support for such concentrations. The number of exposures in each grade shall, however, be sufficient to allow for meaningful quantification and validation.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append the assignment of the exposures to the LGD risk grades. The institution shall also append a quantitative analysis of the homogeneity of the grades with regard to LGD.

As a part of the homogeneity analysis, the institution shall describe the explanatory variables or segment criteria which have been selected or rejected for the division into risk grades and the reasons for the selection of variables/criteria.

If there is a large number of concentrations in one or several risk grades, the institution shall append empirical support for such concentrations.

61. From FFFS 2007:1 Chapter 42, section 13:

“Institutions shall estimate LGDs by grade on the basis of the average realised values in the grade. An institution which treats retail exposures in accordance with section 10, second paragraph may, however, derive the LGD estimates from the average realised loss level and the institution's estimate of PD for the grade.

All defaults within the data sources shall be used for the calculations.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Append all documents describing the institution's method for estimating LGD for each risk grade. The institution shall in particular give reasons for its choice of estimation method.

If the institution has chosen to take into account the risk of additional drawings of credit facilities in its LGD estimate, it shall also specifically describe the manner in which this was done.

The institution shall append an analysis that identifies which defaults are missing/excluded from the historical data and the effect thereof on the estimate.

State the manner in which the institution handled any negative realised LGD in its historical data when estimating LGD.

62. From FFFS 2007:1 Chapter 42, section 14:

“Institutions shall use LGD estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. The institution shall analyse and be able to report the difference between these and the average LGD values.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append an analysis of the manner in which the LGD varies depending on the financial circumstances and the manner in which the institution has taken this into account in its estimate. Refer to relevant sections in the appended methodology documentation.

63. From FFFS 2007:1 Chapter 42, section 15:

“With respect to defaulted exposures, the institution shall make a new estimation of LGD for each specific exposure. This LGD shall be based on information regarding current financial circumstances on the market and the individual exposure.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Account for existing procedures to calculate LGD for defaulted exposures.
Refer to where this is set out in relevant policy documents.

64. From FFFS 2007:1 Chapter 42, section 17:

“The institution shall use the same definition of default in the calculations of the LGD estimates as for the PD estimates.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to relevant sections in the appended data quality analysis that address the data quality reviews the institution has conducted with respect to the definition of default.

65. From FFFS 2007:1 Chapter 42, section 18:

“In this context, "loss" means economic loss and includes all significant direct and indirect costs associated with the handling of an exposure in the default. Potential recoveries shall be calculated at present value to the date of the default. The applied discount rate shall reflect uncertainty on the date of default, regarding the size of potential recoveries.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

State the maximum amount of time that may elapse before a non-closed default is treated as closed. Describe the handling of non-closed defaults that are included in the historic data used when calculating LGD estimates. State the discount rate which is used to calculate the present value of payment streams until the date of default and the manner in which this discount rate is calculated/determined. State the manner in which direct and indirect costs are allocated to each exposure. Refer to relevant methodology documentation.

66. From FFFS 2007:1 Chapter 42, section 19:

“With respect to exposures to institutions, governments and corporates, own estimates of LGD shall be based on data over a minimum of seven years. However, when the institution is permitted to use the IRB approach the estimate may be based on data over a period of five years. The institution shall thereafter gradually base the estimate on data from an increasingly longer period of time until the requirement for seven years of data is met. Where earlier data is available and relevant, the estimates shall also be based on this data.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to where in the appended methodology documentation it is stated that the requirement is met.

67. From FFFS 2007:1 Chapter 42, section 20:

“With respect to retail exposures the estimates shall be based on data over a minimum of five years. Where earlier data is available and relevant, the estimates shall also be based on this data. However, the institution need not accord equal weight to older data as to newer data where it can be shown that, as regards LGD, the newer data has greater predictive power than older data.

With respect to retail exposures in conjunction with its application for permission to use the IRB approach, the institution may be permitted to base the LDG estimates on less than five years' data. However, the LGD estimates must be based on at least two years' data. The data on which the estimates are based must be updated with at least one year of new data for each year that passes after permission was granted. Derogation from the requirement of five years' data is conditional on the institution having a safety margin in its estimates which compensates for the uncertainty resulting from the lack of data.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation. State if the institution will apply for permission in accordance with the second paragraph and the manner in which the institution meets the conditions for permission:

Instructions for how the institution's reply should be formulated:

Refer to where in the appended methodology documentation it is stated that the requirement is met. If the institution has chosen to weight the data, an analysis supporting this decision should be appended. Refer to relevant parts of the appended methodology documentation.

The institution may apply for permission to base the estimate on less than five years of data in accordance with the second paragraph. In such case, the institution shall specifically state that it will apply for such permission and demonstrate the manner in which it meets the requirements for the granting of permission, i.e. that the estimate contains the safety margin that is a prerequisite for permission.

68. From FFFS 2007:1 Chapter 42, section 21:

“Recoveries from financial and non-financial collateral may be considered in the calculation of the LGD estimates if the provisions set out in Chapter 55, sections 6 to 10 and Chapter 54, sections 9-13 are met. However, the institution can make exceptions to the provisions if it can justify why it is not appropriate or reasonable to follow a particular provision. In this case the institution shall also document the exceptions made and their reasons.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall state if it intends to deviate from the provisions and submit documentation about the deviations.

69. From FFFS 2007:1 Chapter 42, section 22:

“An institution shall in a safe manner consider any material correlation between the creditworthiness of the obligor/counterparty and the value of the collateral.

The LGD estimates shall not be based solely on the estimated market value of the collateral. Account must also be taken of the effect of the potential inability of institutions to expeditiously gain control of the collateral or be able to liquidate the collateral.

If the currency is expressed in a different currency than the exposure, the foreign exchange rate risk shall be taken into account by a margin of conservatism when the LGD estimate is calculated.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Report cases where the institution considers there to be a material correlation between the counterparties’ creditworthiness and the value of the collateral. Also show the manner in which this has been taken into account when calculating LGD. State the manner in which the prudence margin for foreign exchange rate risk is calculated in cases where exposures are denominated in a different currency than the collateral and how this affects the calculation of LGD.

Refer to relevant sections in the methodology documentation appended in accordance with previous sections.

70. From FFFS 2007:1 Chapter 42, section 23:

“Where a qualified guarantee or credit derivative exists for an exposure in accordance with sections 24-27, LGD may be adjusted to take this into account. However, the adjustment may not result in a lower risk weight for the protected exposure than would have been the case for an exposure directly to the issuer of the protection.

When PD is adjusted to take into account a guarantee or credit derivative, the risk-weighted exposure amount for the protected portion of the underlying exposure is calculated with the formula set out in Chapter 39 for the exposure class to which the issuer of the guarantee or credit derivative belongs.”

State the manner in which the institution takes into account the effect of guarantees and credit derivatives:

Instructions for how the institution’s reply should be formulated:

State in which cases LGD or PD may be adjusted for guarantees. Show the manner in which the institution ensures that the risk weight is not lower than the risk weight that can be calculated with the guarantor’s PD and LGD.

State what portion of the exposures in each exposure class is adjusted to take into account the effect of guarantees and credit derivatives.

71. From FFFS 2007:1 Chapter 42, section 24:

“Institutions shall have clear rules for the adjustment of LGD. Such rules must be consistent with the requirements of these provisions concerning the manner in which assignment to grades shall take place. The instructions must also contain criteria regarding the manner in which the adjustment is affected by the following factors:

- 1. The ability and the willingness of the guarantor to comply with its obligations under the contract.*
- 2. The connection between the payment capability of the direct counterparty and that of the guarantor.*
- 3. The period of time within which receipt of any payments under the guarantee may be expected. In particular, consideration shall be given to the payout structure of credit derivatives.*
- 4. Whether a complete risk transfer is believed to have taken place or whether any residual risk remains with the original obligor.*
- 5. The manner in which the risk transfer is affected by the fact that the maturity of the protection does not coincide with that of the exposure.”*

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which LGD or PD is adjusted to take into account the effect of guarantees and credit derivatives. Refer to appended policy documents, manuals or other relevant documentation in which the institution’s regulations are documented. In particular, refer to the sections in which it is stated the manner in which the institution complies with each point in the section. The description shall specifically address compliance with the five points where only limited historical information is available.

72. From FFFS 2007:1 Chapter 42, section 25:

“Adjustment of LGD may take place only where the guarantor is rated in accordance with the provisions regarding risk-weighting for direct counterparties. The institution shall document its internal criteria regarding cases in which adjustment shall take place.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the criteria that determine in which cases an adjustment may occur. Also refer to where such criteria are set forth in the institution’s policy documents.

73. From FFFS 2007:1 Chapter 43, section 2:

“M shall be 2.5 years for all exposures with the exception of repurchase transactions and securities or commodities lending or borrowing transactions. For exposures arising from repurchase transactions and securities or commodities lending or borrowing transactions, M shall be 0.5 years.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall state the portion of its total portfolio which have been assigned a maturity of 2.5 years and 0.5 years, respectively. In addition, the institution shall append its internal definitions of exposures for which M shall be set to 0.5.

Only applies to institutions applying for permission in accordance with Chapter 38, section 6.

74. From FFFS 2007:1 Chapter 43, section 6-11:

””

State in general the manner in which the institution complies with the sections and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

The institution shall append documentation that describes the IT system's general structure for carrying out internal calculations.

The institution shall account for the manner in which the data quality is established and state the average maturity per exposure class.

Note that the sections in Chapter 44 apply to all PD, LGD and conversion factor risk dimensions for which the institution uses own estimates. The replies shall therefore also include all three risk dimensions. The sections also apply to product grading in the CF dimension unless otherwise stated.

75. From FFFS 2007:1 Chapter 44, section 2:

“If an institution uses multiple product or risk grading methods for the same risk parameter, there shall be clear criteria for which method that shall be used for a certain type of exposure or counterparty. These criteria must take the risk profile of the exposures and obligors into account.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to where it is set out in the appended policy documents the criteria with respect to which product or risk grading methods that shall be used and for which type of exposure or counterparty

Does not apply to product grading.

76. From FFFS 2007:1 Chapter 44, section 3:

“The institution shall periodically review the choice of risk classification methods to determine whether they remain appropriate for the current portfolio and external conditions.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which the evaluation is conducted and by whom/which function. Also describe when/based on which situations the evaluation is conducted.

Describe in general the underlying motives for the choice of approach already made by the institution (for example why the expert-based method or statistical method was chosen). Refer to appended documentation.

77. From FFFS 2007:1 Chapter 44, section 4:

“The institution bears responsibility for compliance with the provisions of this Chapter also where, for example, it participates in a co-operation with other institutions regarding method development or pooling of data. The same also applies where the institution uses an externally developed model for assignment of grades and estimation of parameters.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Specify the exposures and/or portfolios for which the institution uses models that totally or partially were developed by external parties and the exposures and/or portfolios for which the institution uses pooled data.

Does not apply to product grading.

78. From FFFS 2007:1 Chapter 44, section 5, first and second paragraphs:

“An institution shall have instructions with specific descriptions, criteria, and procedures for assigning exposures and counterparties to grades within a rating system.

The instructions shall be sufficiently detailed to allow for the risk grading/rating to be performed consistently within the institution. The institution shall have descriptions and criteria for each individual grade. The documentation of the rating process shall allow third parties to evaluate the application of grades in specific cases.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to where in the appended documentation it is stated the manner in which the requirements in this section are met.

Does not apply to product grading.

79. From FFFS 2007:1 Chapter 44, section 5, third paragraph:

“The criteria shall also be consistent with the institution's internal lending standards and its policies for handling troubled obligor and exposures.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Describe the manner in which the requirement is met. Append policy documents and refer to the parts thereof in which this is addressed. The information shall contain the limits applicable for refusals to extend credit and the manner in which these are linked to the risk grade. The information shall also provide a description of the manner in which the risk grading is linked to the handling of credit that is deemed to be more risky, for example the frequency in credit follow-up.

80. From FFFS 2007:1 Chapter 44, section 7:

“The estimates of the risk parameters (CF, PD and LGD) shall be derived using both historical experience and empirical data, and not be based purely on qualitative considerations. The institution shall be able to demonstrate that its estimates are representative of its loss experience. Before the estimates are confirmed, the institution shall assess whether they are reasonable.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which the problems of lack of data were addressed, for example for portfolios with low frequency of default. State for which portfolios external data and qualitative assessments have had a material effect on the estimate. Refer to relevant sections in appended documentation.

The institution shall in particular describe the manner in which the final calibration was decided, who is responsible for the decision, what was taken into account and what considerations were made.

Does not apply to CF.

81. From FFFS 2007:1 Chapter 44, section 8:

“The estimates of PD and LGD shall be based on the most important explanatory factors for the risk. The institution shall be able to provide a breakdown of its loss experience for PD and LGD per explanatory factor.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall present a simple analysis showing the manner in which the outcomes in each of the PD and LGD risk dimensions co-vary with the values in each of the initial explanatory variable in the models (univariable analysis).

The requirement to use the most material explanatory factors will be assessed in accordance with the relevant sections of Chapters 40-42.

82. From FFFS 2007:1 Chapter 44, section 11:

“The portfolio of exposures on which the estimates of the risk parameters are based shall be comparable with the institution's current portfolio. The aforesaid shall also apply to routines and practices in the credit process as well as other factors of relevance to the value of the risk parameters. When the institution estimates the risk parameters, it shall take into account any changes in routines and practices in the credit process which may be expected to affect the risk. The institution shall also demonstrate that the economic or market conditions during the period the estimates are based on are relevant to its current economic and market conditions.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

State what data is used in the estimates for the different portfolios. Append the analyses the institution has conducted to ensure that the data is representative (or refer to analyses that are appended under Chapters 40-42.) This also applies if the institution has used internal data. The analyses shall as a minimum address the points listed in the section.

83. From FFFS 2007:1 Chapter 44, section 12:

“The number of exposures in the sample and the data period used for quantification shall be sufficient to allow for accurate and robust estimates. The institution shall add to its estimates a safety margin reflecting the expected range of estimation errors. The less data an institution has in terms of both length of the observation period and number of observations, the wider the safety margin shall be.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append a quantitative analysis of the manner in which safety margins in the risk parameters have been determined based on statistical margins of error. Analyses other than purely statistical ones are satisfactory for portfolios with low frequency of default where sufficient data is lacking.

84. From FFFS 2007:1 Chapter 44, section 13:

“The requirements of this section shall apply irrespective of whether the institution uses internal or external data. Where pooled data is used, the institution shall particularly ensure that the criteria of the other participating institutions used in the risk grading in all material respects are similar to its own.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State which portfolios use pooled data. Describe the manner in which the institution has ensured that the condition in the section’s second sentence is met.

Does not apply to CF.

85. From FFFS 2007:1 Chapter 44, section 15, first sentence:

“Each assignment to a grade, whether new or a re-assignment, must be approved by a function that does not directly benefit from decisions to extend the credit.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State which level/function proposes risk grades and which level/function decides on risk grades.

Append policy documents and refer to where they address this requirement. (Note the exception for retail exposures as per the section’s second sentence.)

Does not apply to CF.

86. From FFFS 2007:1 Chapter 44, section 15, second sentence:

“With respect to retail exposures, however, it is sufficient that such a function carries out a retroactive control of the ratings on an aggregated basis.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to appended policy documents to show the manner in which ex post control is carried out and which function is responsible for this.

Does not apply to CF.

87. From FFFS 2007:1 Chapter 44, section 16, first and second paragraphs:

“Where the institution obtains new information which significantly affects the assessment of the credit risk of the counterparty or the exposure, the institution shall make a new grade assignment.

With respect to exposures to institutions, governments and corporates, the institution shall have an effective process to regularly obtain and update relevant information that may materially affect the risk grading of obligors and exposures.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which new information is handled and the manner in which the institution acts thereon. Append instructions or similar policy documents in which this requirement is addressed and refer to where in the appended documentation they are addressed.

Describe the manner in which the institution endeavours to regularly obtain new information regarding the exposure or counterparty and append and refer to the parts of the instructions/policy documents where this is addressed.

Does not apply to CF.

88. From FFFS 2007:1 Chapter 44, section 16, third and fourth paragraphs:

“The institution shall always at least annually re-evaluate all risk grade assignments. With respect to retail exposures, this may take place through a review of a representative sample of exposures or obligors within each grade as a means of ensuring that the risk grading is stable.

Risk grading of high-risk obligors and exposures shall be subject to more frequent review.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which it is ensured that a re-evaluation of the rating is conducted at least once a year. If a re-evaluation of the rating for retail exposures is not conducted for each individual exposure, the institution shall also describe in detail the manner in which the re-evaluation of the rating for the retail portfolio is carried out.

Describe the procedures that exist for following up particularly high risk exposures and counterparties.

Refer to relevant sections in policy documents that address procedures for re-evaluation and follow-up.

Does not apply to CF.

89. From FFFS 2007:1 Chapter 44, section 17:

“The institution shall have documented principles for when it is permitted to override a mechanically calculated rating, as well as for the approval procedures for such departures. Institutions shall individually document all overrides from the mechanically calculated risk grade. The institution shall in particular analyse and document the outcome of these overrides in accordance with the same principles as prescribed in Section 28.

With respect to exposures to governments, institutions and corporates, the credit officer shall at all times make a qualitative assessment of the suitability of the grade indicated by the mechanical method.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the procedures for determining risk grades when automated decision methods are used. Refer to where it is stated in relevant policy documents that it is possible to propose a risk grade other than the automatic calculation. Also refer to the section in which the obligation to “*make a qualitative assessment of the suitability of the grade indicated by the mechanical method*” is stated.

Describe the procedures set up with regard to so-called overrides. The description shall include the manner in which ex post controls are carried out, how often, by whom, etc. Refer to relevant sections in the appended policy documents.

Also append the latest analysis of the results of the overrides.

90. From FFFS 2007:1 Chapter 44, section 18, last sentence:

“The institution shall also document all major changes in the risk rating system.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the institution’s procedures for documenting changes in the rating system and refer to policy documents where this procedure is set forth.

91. From FFFS 2007:1 Chapter 44, section 23:

“In respect of all of its exposures, the institution shall collect and store the following data regarding the risk dimensions where the institution has been permitted to use own estimates:

- 1. A complete rating history of product and risk classifications for exposures or obligors, including guarantors.*
- 2. The date for product rating and risk rating.*
- 3. The data and methodology used to derive the rating.*
- 4. The person responsible and decision level for the product rating and risk rating.*
- 5. Which obligors and exposures that defaulted as well as the date and circumstances of such defaults.*
- 6. PD estimates and realised default rates associated with each PD rating grade and ratings migration.*

With respect to exposures where the institution uses prescribed values of LGD and conversion factors, it shall collect and store data on both the prescribed and realised LGD and conversion factors for each risk and product grade.

With respect to the exposures where the institution has been permitted to use own estimates of LGD and conversion factors, it shall collect and store:

- 1. The estimates of LGD and conversion factors as well as realised values for each risk and product grade. Where the institution gives consideration to the effects of guarantees or credit derivatives through LGD estimates, this applies both before and after these.*
- 2. All components of the realised losses.”*

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Provide a general description of which system and databases are used to store the data referred to in this section.

State which measures the institution has taken (procedures, logical controls, etc.) to ensure that the data is of high quality.

92. From FFFS 2007:1 Chapter 44, section 24:

“The institution shall in a suitable way test what effects potential future events and external changes may have on its credit risks and capital adequacy. The tests shall be carried out regularly and at least once a year. They shall cover a majority of the institution's exposures. The tests shall be meaningful and based on reasonably conservative assumptions.

The tests shall involve at least the effects of an economic downturn and an analysis of migration in the ratings as a result of the assumed future events and external changes.

The tests shall result in an assessment of the institution's ability to withstand such events and external changes.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

State the types of stress tests and scenario analyses that are conducted. Also state the frequency with which they are conducted and to whom (board of directors, managing director, etc.) the stress tests are reported.

Append methodology documentation for the stress tests.

Append examples of stress test reports.

93. From FFFS 2007:1 Chapter 44, section 26:

“Institutions shall have robust systems in place to validate the risk rating systems and the estimates of the risk parameters. The validation process shall enable a consistent and meaningful analysis of whether the risk rating system measures risk in a satisfactory manner. The validation process shall be performed consistently.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append all policy documents that refer to validation, from general principles to detailed manuals.

94. From FFFS 2007:1 Chapter 44, section 27:

“Validation shall take place regularly, at least once per year.

An institution shall compare realised values with the estimated risk parameters in those dimensions - PD, LGD, conversion factors - where own estimates are used. The analysis shall cover the most recent period as well as the entire period the institution has available data.

Regarding the PD dimension, institutions shall also analyse the strengths of the rating system's discriminatory power, i.e. how well the institution's assignment of grades distinguishes counterparties and exposures that default during the period from other counterparties and exposures.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Refer to where it is stated in the appended policy documents that validation shall occur regularly and at least once a year.

Append completed validation reports, backtesting, tests regarding differentiation capability and an analysis in which are stated the conclusions drawn by the institution from the outcome of the tests.

95. From FFFS 2007:1 Chapter 44, section 28:

“Validation in accordance with section 27 shall take place on such a level that it provides a basis for judging how well the rating system functions specifically for the institution's various types of exposures and counterparties and for different markets.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Describe on what level the validation is carried out and give reasons. Refer to where this is addressed in relevant policy documents.

96. From FFFS 2007:1 Chapter 44, section 29:

“The validation of estimates shall take place on such a detailed level that it can also be used as a basis for analysing whether the product and risk rating is done in a consistent manner in all parts of the institution. In the absence of a sufficient quantity of outcome data, the last-mentioned analysis shall take place in another manner.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Refer to where in the appended methodology documentation it is stated the manner in which this type of validation is conducted. Append reports from conducted validations as well as an analysis showing the conclusions drawn by the institution from the validation.

97. From FFFS 2007:1 Chapter 44, section 30:

“If external data exists that is relevant for the institution's portfolio and the current time period, institutions shall regularly make comparisons with this data as a step in the validation process.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

State if the institution has identified any relevant external data for use in the validation. If a comparison analysis with external data is carried out, append the analysis.

Does not apply to product grading.

98. From FFFS 2007:1 Chapter 44, section 31 and section 32:

“Before the institution employs a statistical model in the rating process, a rigorous validation process must be in place. This validation process shall test the predictive power of the model on out-of-time and out-of-sample data.”

“If an institution uses statistical models or other mechanical methods for its risk grade assignments, the institution must be able to demonstrate that the methods are free of any systematic errors.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append the validation reports of statistical models used in the rating process. Append analyses describing the conditions under which the predictive ability of the model may be compromised.

99. From FFFS 2007:1 Chapter 44, section 33:

“The institution shall at all times take appropriate measures where the validation process demonstrates that the results deviate more than expected from the institution's estimates and ratings. The institution shall outline the measures to be taken in an appropriate document. The analysis shall take account of business cycles and similar systematic variability in realised default and losses. The institution shall revise its estimates upwards where realised values show risk parameters to be higher than the estimated values during a longer time period.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Append policy documents establishing the measures that shall be taken when the outcome deviates to a greater extent than expected. Append examples of where measures were taken.

100. From FFFS 2007:1 Chapter 44, section 34:

“Institutions shall regularly carry out a qualitative assessment of the quality of the structure and use of the rating system. Institutions shall document the qualitative assessments and resulting measures.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which qualitative assessments shall be carried out and by whom/which function. Also show the impact of the qualitative assessments on the validation process.

Append the results of a conducted analysis or refer to the parts of the validation analysis where the results are presented. Refer to where in the appended policy documents the qualitative validation is addressed.

101. From FFFS 2007:1 Chapter 44, section 35:

“Internal product and risk ratings and estimates of risk parameters shall be used as an integrated part of the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the institution. The estimates shall be accepted by the business organisation.

Each new obligor or exposure shall be assigned a product and risk rating as part of the credit approval process.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State and describe the extent to which the internal product and rating system will be used as an integrated part of the institution’s business processes in certain contexts.

State the date when product grades or risk grades for a specific obligor or exposures are assigned. Refer to relevant policy documents.

102. From FFFS 2007:1 Chapter 44, section 36:

“If the institution does not use the same risk parameter values in its business processes as in its calculation of the capital requirement, the institution shall be able to demonstrate that the values which are used internally are reasonable. The institution shall also document cases where it uses different values in its business processes and in calculating the capital requirement.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State to what extent the institution uses risk parameter values in internal business processes that deviate from the values that are available for an institution to use in the capital calculation. If other values are used internally, the institution shall append documentation showing that other values are used and that they are reasonable.

103. From FFFS 2007:1 Chapter 44, section 37:

“The person at the institution responsible for the credit decision shall, when the credit decision is made, be aware of the rating of the counterparty and the exposure, the product rating of the exposure as well as the information regarding the counterparty and the exposure on which the product and risk grade is based. The aforesaid shall also apply where statistical models are used for calculating grades.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

The institution shall describe how the person at the institution responsible for the loan decisions obtains information about the product and risk grade of the obligor and exposure during the loan decision. In addition, the institution shall describe the manner in which the person obtains information about what the product and risk grading of the obligor and the exposure is based on and what information it receives. Append examples of the information leaflets or similar documents from which the person(s) can infer the information.

104. From FFFS 2007:1 Chapter 44, section 38, second paragraph:

“An institution which does not use own estimates of LGD and conversion factors for its exposures to institutions, governments and corporates must have used its rating system for at least one year in 2007, at least two years in 2008 and 2009, and at least three years commencing 2010.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe in general terms the order in which and when the different parts of the rating system are implemented and applied.

Only applies to institutions applying for permission in accordance with Chapter 38, section 6.

105. From FFFS 2007:1 Chapter 44, section 38, third paragraph:

“An institution which uses own estimates of LGD and conversion factors for its exposures to governments, institutions and corporates must have used its rating system for at least two years in 2008 and at least three years commencing in 2009.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe in general terms the order in which and when the different parts of the rating system are implemented and applied.

106. From FFFS 2007:1 Chapter 44, section 39:

“All material aspects of the rating and estimation processes shall be approved by the institution's Board of Directors or a designated committee thereof. Board members and the managing director shall possess a good general understanding of the institution's rating systems and detailed comprehension of its associated management reports.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Describe the process of the financial group for ensuring that all material parts of the rating system are approved by the board of directors in each firm that intends to apply the IRB approach. It is not necessary to submit the minutes of board meetings from each legal entity, but the minutes from board meetings where the board of directors of the group have taken relevant decisions and examples of minutes from subsidiaries shall be appended.

Describe the training and information the board of directors received in order to be able to approve the rating system and understand the content in received reports sent to them regarding the rating system.

State which policy documents regarding the rating system were decided upon by the board of directors.

107. From FFFS 2007:1 Chapter 44, section 41:

“The Managing Director shall have a good understanding of the design and use of the rating systems and ensure, on an ongoing basis, that the rating systems are operating properly. The managing director shall be regularly updated by the central unit for independent control and analysis of credit risk. The information shall cover the conclusions from the validation process, the areas that need improvement and how previously decided improvement measures are progressing.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Describe the training specifically provided to ensure that the managing director has a sound understanding of the structure and use of the rating system. The description shall specify the manner in which the group’s managing director has been informed and contain a general description of the training for managing directors in the subsidiaries.

Also state what information the managing director regularly receives from the risk control unit and how this information is obtained. A more detailed description of the methods by which the group’s managing director obtains information and a general overview of the other units in the group shall also be provided.

108. From FFFS 2007:1 Chapter 44, section 42:

“The central component of the regular reporting of credit risk to the board of directors and the managing director shall be based on the institution’s risk rating, product rating and risk estimates. Reporting shall include at least the assignment of counterparties and exposures by grade, risk estimates by each risk grade and product grade, comparison between estimates and realised outcome for each product grade and risk grade, migration across risk grades and stress-test information and results. Reporting frequencies shall depend on the significance and type of information and the level of the recipient.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

Append a copy of the latest group-level reports which were submitted to the board of directors and the managing director. State the frequency with which the regular reporting takes place. If the content (other than which part of the group the report relates) and frequency varies between the group and lower levels, these differences shall be illustrated and commented on.

109. From FFFS 2007:1 Chapter 44, section 44:

“The unit for independent credit risk control and analysis shall report directly to the managing director. Alternately, the unit could report to another senior executive who reports directly to the managing director, is not responsible for the daily credit or commercial operations but possesses good knowledge of credit risks. The unit's duties shall not be performed by personnel who are engaged in the ongoing credit management or other business activities. The unit shall have sufficient resources for its duties and personnel with good knowledge of credit risks.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Describe the manner in which the central risk control unit is organised within the institution. Append an outline of the organisation. Also describe how the unit is staffed and organised internally. If there are several risk control units within the group, these shall also be described in the same manner.

110. From FFFS 2007:1 Chapter 44, section 45:

“The unit for independent credit risk control and analysis shall be responsible for the design, implementation, oversight and follow-up of the institution's rating system. The unit's duties shall include the following.

- 1. Responsibility for ensuring that the institution has a validation process which complies with the provisions of these regulations.*
- 2. Regular review of the rating criteria to evaluate if they remain predictive of risk.*
- 3. Regular review of the criteria used for product rating.*
- 4. Responsibility for the documentation of the rating system as stipulated in these provisions.*
- 5. Production of reports from the rating system.*
- 6. Active participation in the design, implementation, continuing oversight and modification of models used in the rating process and the estimation of risk parameters.”*

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Describe all of the risk control unit's areas of responsibility and refer to the policy documents in which these responsibilities are regulated. Also describe relevant interfaces for these responsibilities in relation to other organisational units.

111. From FFFS 2007:1 Chapter 44, section 46:

“An institution which uses pooled data for its grade rating and estimates of risk parameters may outsource the following duties to the entity which organises the data pooling:

- 1. Production of information relevant to validation of grades and risk estimates.*
- 2. Production of reports from the rating system.*
- 3. Production of information relevant to regular review of the rating criteria to evaluate if they remain predictive of risk.*
- 4. Documentation of all changes to the rating process, including the criteria used for the risk grading.*
- 5. Production of information relevant to ongoing review and modifications to models used in the rating process and estimation of risk parameters.*

An institution which outsources duties pursuant to this provision shall ensure that

- 1. Finansinspektionen has access to all information from the organiser of the data pooling which Finansinspektionen deems necessary for the supervision of the rating system, and that*
- 2. Finansinspektionen is entitled to carry out investigations to the same extent as at the institution.”*

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution’s reply should be formulated:

State the extent to which the institution intends to participate in data pooling pursuant to this provision.

112. From FFFS 2007:1 Chapter 44, section 47:

“In order to receive permission in accordance with Chapter 4, section 7 of the Capital Adequacy Act, the institution must be able to prove that it can properly calculate and report the capital requirement in accordance with the IRB approach.

The institution shall, before receiving permission in accordance with Chapter 4, section 7 of the Capital Adequacy Act and in addition to the ordinary capital adequacy reporting, report to Finansinspektionen in a separate report the capital requirement in accordance with the IRB approach. The reporting shall take place four times at one financial quarter intervals. The reporting shall be executed at the group level and include the exposures for which the institution intends to calculate the capital requirement in accordance with the IRB approach as of the date permission is granted.

The requirement for this reporting also applies for the exposures that are included in the implementation plan in accordance with Chapter 38, section 19. For these exposures, the reporting shall be executed four times at one financial quarter intervals before the institution may calculate the capital requirement in accordance with the IRB approach for the relevant exposures. However, the institution may apply for permission to report a fewer number of times or not at all for these exposures. Permission in accordance with this paragraph may only be granted if Finansinspektionen judges that the permission does not decrease Finansinspektionen’s possibilities for determining if the institution fulfils the provisions related to the IRB approach. Permission may be granted per exposure class, for retail exposures per sub-group, and business line.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation. The institution shall also state if it intends to apply for permission in accordance with the section:

Instructions for how the institution’s reply should be formulated:

Describe the manner in which the quality of the reporting is ensured.

If the institution applies for permission, it shall state the exposures for which it is applying and the number of occasions they are requesting not to report.

113. From FFFS 2007:1 Chapter 44, section 48:

“Internal audit shall review at least annually the institution's rating systems and its use thereof. Areas of review shall include adherence to all applicable provisions in these regulations.”

State the manner in which the institution complies with the section and refer to relevant, appended documentation:

Instructions for how the institution's reply should be formulated:

Append the most recently adopted audit plan. Also append reports from the internal audit's most recently conducted audits with the focus referred to in this provision.

Describe the internal audit's staffing, competence and resources with respect to IRB approaches. State in particular the measures taken by the institution to improve its competence in order to meet the increased demands on the internal audit as a result of using an IRB approach.