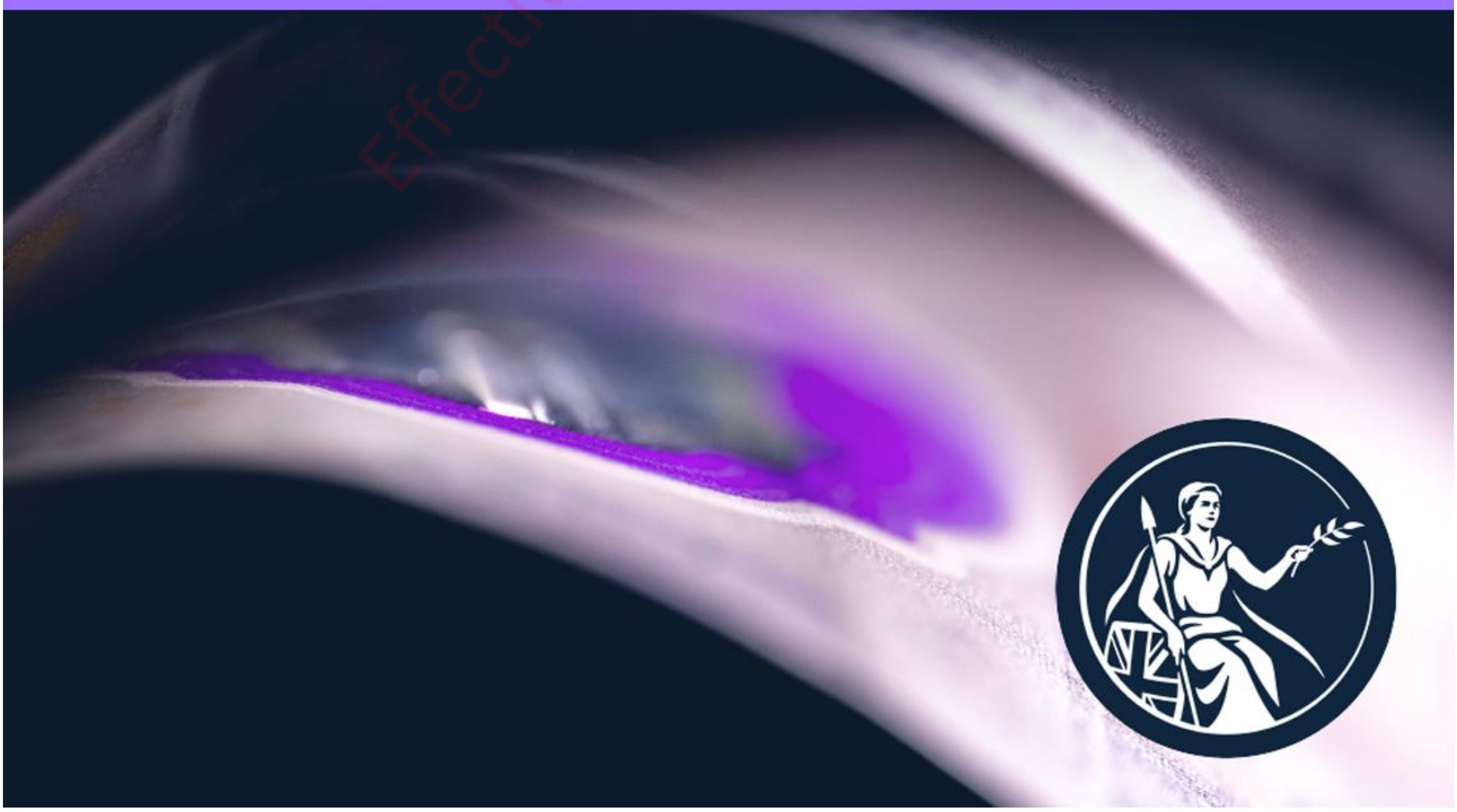
Bank of England PRA

Identification of groups of connected clients for large exposures purposes

Supervisory statement | SS3/25

July 2025



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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

1. Introduction

1.1 This supervisory statement (SS) is relevant to all CRR firms and CRR consolidation entities.

1.2 This SS outlines the Prudential Regulation Authority's (PRA) expectations in relation to the approach firms should take when grouping two or more clients into a 'group of connected clients' (GCC) in accordance with the definition in the Large Exposures (LE) (CRR) Part of the PRA Rulebook. It covers:

a. groups of connected clients based on control;
b. an alternative approach for exposures to central governments;
c. establishing interconnectedness based on economic dependency;
d. the relation between interconnectedness through control and interconnectedness through economic dependency;
e. control and management procedures for identifying connected clients; and
f. illustrative scenarios.

1.3 This SS does not cover the approach firms should take when considering groups of connected clients in other parts of the PRA Rulebook and CRR. It only covers the approach in relation to the Large Exposures (CRR) Part.

1.4 This SS should be read in conjunction with the specified CRR articles, the requirements in the PRA Rulebook and the high-level expectations outlined in the PRA's approach to banking supervision, as well as any additional sources and legislation listed in the document.

Definitions

1.5 The PRA has created definitions of group of connected clients and control in the Large Exposures (CRR) Part of the PRA Rulebook. These definitions are to be used by firms when applying the Large Exposures Part of the PRA Rulebook instead of the equivalent definitions in the CRR. However, the CRR definitions of group of connected clients and control remain relevant to other parts of the PRA Rulebook. Unless otherwise specified, other terms used in this SS have the same meaning as in the CRR and the Large Exposures (CRR) Part of the PRA Rulebook.

2. Groups of connected clients based on control

2.1 When applying the definition of group of connected clients in Rule 1.2 of the Large Exposures (CRR) Part of the PRA Rulebook firms are required to treat two or more clients as a group of connected clients constituting a single risk when there is a control relationship between them.

2.2 The PRA expects firms to provide it with their analysis where, in exceptional cases, firms determine that no single risk exists despite the existence of a control relationship among clients. For example, in specific cases where a special purpose entity that is controlled by another client (eg an originator), is fully ring-fenced and bankruptcy remote – so that there is no possible channel of contagion, and hence there is no single risk between the special purpose entity and the controlling entity – it may be possible to demonstrate to the PRA that no single risk exists (see scenario C1).

2.3 Firms should apply the definition of control in that rule as follows:

a. Firms should group clients on the basis of their consolidated financial statements where those consolidated financial statements are prepared in conformity with UK-adopted international accounting standards. Firms should rely on the definition of control based on the relationship between a parent undertaking and a subsidiary undertaking within the meaning of the accounting standards under section 403(1) of the Companies Act 2006 or section 1162 of the Companies Act 2006.

b. In relation to clients that do not prepare their consolidated financial statement in conformity with UK-adopted international accounting standards, (eg natural persons, central governments, and clients that prepare consolidated financial statements in accordance with the accounting rules of a third country), firms should deem there to be a control relationship between any natural or legal person and an undertaking that is similar to the relationship between a parent undertaking and subsidiary undertaking mentioned in point (a) of this paragraph.

2.4 Clients that are not included in the same consolidated financial statements because exemptions apply to them under the relevant accounting rules should still be included in a group of connected clients.

2.5 Firms should group two or more clients into a group of connected clients on account of a relationship of control among these clients regardless of whether the exposures to these clients are exempted from the application of the large exposures limit under Article 400(1) and (2) of the Large Exposures (CRR) Part of the PRA Rulebook.

3. Alternative approach for exposures to central governments

3.1 In line with the definition of 'group of connected clients' in Rule 1.2 of the Large Exposures (CRR) Part of the PRA Rulebook, firms may assess the existence of a group of connected clients separately for each of the persons directly controlled by or directly interconnected with the central government ('alternative approach').

3.2 The use of the alternative approach is at the discretion of the firm. Firms may:

a. form one group of connected clients with the central government and all its connected clients; or
b. form two or more separate groups of connected clients depending on the number of connected clients directly controlled by or directly interconnected to the central government.

3.3 Firms are not permitted to form separate groups of connected clients where they are indirectly controlled by, or indirectly interconnected to, the central government, (eg a separate group of connected clients consisting of the central government and a subsidiary of a subsidiary of the central government) (see scenario CG1 in the annex).

3.4 When applying the alternative approach, firms are required to ensure that:

a. The central government is included in each separate group of connected clients related to the central government (see scenario CG2 in the annex).
b. Each group of connected clients under 3.4 (a) includes also persons controlled by, or interconnected with, the person who is directly controlled by or directly interconnected with the central government (see scenario CG3).

3.5 Where the entities directly controlled by, or directly interconnected to, the central government are economically dependent on each other, they should form separate groups of connected clients (excluding the central government), in addition to the groups of connected clients formed in accordance with the alternative approach (See Scenario CG4).

3.6 This chapter of the SS also applies to regional governments or local authorities to which Article 115(2) of CRR applies and in the United Kingdom regional governments means the Scottish Government, the Welsh Government and the Northern Ireland Executive.

4. Identifying groups of connected clients based on economic interconnection

4.1 When assessing if clients are interconnected in accordance with the groups of connected clients definition in rule 1.2 of the Large Exposures (CRR) Part of the PRA Rulebook, firms should take into account the specific circumstances of each case, in particular whether financial difficulties or the failure of a client would lead to funding or repayment difficulties for another client (see scenarios E1, E2, E3 and E4).

4.2 Where a firm can demonstrate to the PRA that the financial difficulties or the failure of a client would not lead to funding or repayment difficulties for another client, these clients do not need to be considered as a single risk. In addition, two clients do not need to be treated as a group of connected clients if a firm can demonstrate to the PRA that a client is economically dependent on another client in a limited way, meaning that one client can easily replace the other client.

4.3 Firms should consider the following non-exhaustive situations when assessing economic dependency:

a. Where a client has fully or partly guaranteed the exposure of another client and the exposure is so significant for the guarantor that they are likely to experience financial problems if a claim occurs.[1]

b. Where a group of connected clients based on control does not exist but a client is liable in accordance with its legal status as a member in an entity, for example a general partner in a limited partnership, and the exposure is so significant for the client that they are likely to experience financial problems if a claim against the entity occurs.

c. Where a significant part of a client's gross income or expenditure (on an annual basis) is derived from transactions with another client that cannot be easily replaced (eg where the owner of a residential or commercial property receives rent which contributes to a high portion of their income).

d. Where a significant part of a client's production or output is sold to another client of the firm, and the production or output cannot be easily sold to other customers.

e. Where the expected source of funds to repay the loans of two or more clients is the same and none of the clients has another independent source of income from which the loan may be serviced and fully repaid.

1 This situation refers to guarantees in relation to which the substitution approach referred to in Article 403 of the Large Exposures (CRR) Part of the PRA Rulebook does not apply.

f. Other situations where clients are legally or contractually jointly liable for obligations to the firm (eg a debtor and his or her co-borrower, or a debtor and his or her spouse or partner).

g. Where a significant part of the receivables or liabilities of a client is to another client.

h. Where clients have common owners, shareholders, or managers but a group of connected clients based on control does not exist. For example, horizontal groups where an undertaking is related to one or more other undertakings because they have the same shareholder or because they are managed on a unified basis. This management may be pursuant to a contract concluded between the undertakings, or to provisions in memoranda or articles of association of those undertakings, or if the administrative management or supervisory bodies of the undertaking and of one or more other undertakings consist mostly of the same persons.

4.4 Firms should also consider the non-exhaustive list of situations in paragraph 4.3 when assessing connections among shadow banking entities. Firms should give due consideration to the fact that relationships between shadow banking entities will most likely consist not of equity ties but rather of a different type of relationship, ie situations of de facto control or relationships characterised by contractual obligations, implicit support, or potential reputational risk (eg sponsorship or even branding).

4.5 Where a firm's client is interconnected to more than one client, which are not dependent on each other, the firm should include the clients in separate groups of connected clients (together with the dependent client).

4.6 Firms should group clients into a group of connected clients where two or more of their clients are economically dependent on an entity, even if this entity is not a client of the firm.

4.7 Firms should group two or more clients into a group of connected clients on account of economic dependency among these clients regardless of whether the exposures to these clients are exempted from the application of the large exposures limit under Article 400(1) and (2) in the Large Exposures (CRR) Part of the PRA Rulebook.

Economic dependency through a main source of funding

4.8 Firms should consider situations where funding problems of one client are likely to spread to another client. Such funding connections may either be one-way or two-way (scenarios CE1 and CE2, respectively). This does not include cases where clients get funding from the same market (eg the market for commercial paper) or where the clients' dependency on an existing source of funding is caused by clients' deteriorating creditworthiness, such that they cannot easily replace that source of funding.

4.9 Firms should consider cases as economic dependencies where a firm provides the common source of funding itself, its financial group, or its connected clients (see scenario E5). Being clients of the same institution does not in itself create a requirement to group the clients into a group of connected clients if the institution providing the funding can be easily replaced.

4.10 Firms should also assess any contagion or idiosyncratic risk that could emerge from the following situations:

a. Use of one funding entity (eg the same bank or conduit that cannot be easily replaced);

b. Use of similar structures; or

c. Reliance on commitments from one source (eg guarantees, credit support in structured transactions or non-committed liquidity facilities), taking into account its solvency, especially where there are maturity mismatches between the maturity of underlying assets and the frequency of the refinancing needs.

5. Relation between interconnectedness through control and interconnectedness through economic dependency

5.1 Firms should first identify which clients are groups of connected clients via point (1) of the ‘group of connected clients’ definition and the ‘control’ definition in rule 1.2 of the Large Exposures (CRR) Part of the PRA Rulebook, and which clients are interconnected via economic dependence in accordance to point (2) of the ‘group of connected clients’ definition. Subsequently, firms should assess whether connections exist between different groups of connected clients.

5.2 In their assessment, firms should consider each case separately based on the individual circumstances (see scenarios CE1, CE2, CE3 and CE4).

6. Control and management procedures for identifying connected clients

6.1 Firms should have a thorough knowledge of their clients and their clients' relationships.

6.2 Identification of possible connections among clients should be an integral part of a firm's credit granting and surveillance processes. The management body and senior management should ensure that adequate processes for the identification of connections among clients are documented and implemented.

6.3 Firms should identify all control relationships among their clients and document as appropriate. Firms should equally investigate and document any economic dependencies among their clients. Firms should take reasonable steps and use available information to identify these connections. If, for example, a firm knows that clients are treated as a group of connected clients by another institution (eg because of the existence of a public register), it should take this into account.

6.4 There are cases where a thorough investigation of economic interdependencies will not be proportionate to the size of the exposures. Therefore, firms are expected to conduct a thorough investigation in all cases where the sum of all exposures to one individual client exceeds 5% of the firm's Tier 1 capital.

6.5 To assess groups of connected clients based on a combination of control and economic dependency relationships, firms should collect information on all entities that could pass financial difficulties from one group of connected clients to another (see Scenarios CE1, CE2, CE3, and CE4). Firms might not be able to identify all clients that constitute a group of connected clients if there are interconnections that stem from entities that are not in a business relationship with the firm and are therefore unknown to the firm. However, if a firm becomes aware of interconnections via entities outside its clientele, it should use this information when assessing connections.

6.6 Control and management procedures for identifying groups of connected clients should be subject to periodic review to ensure their appropriateness. Firms should also monitor changes to interconnections of its clients, at least in the context of their periodic loan reviews and when a substantial increase to a loan is planned.

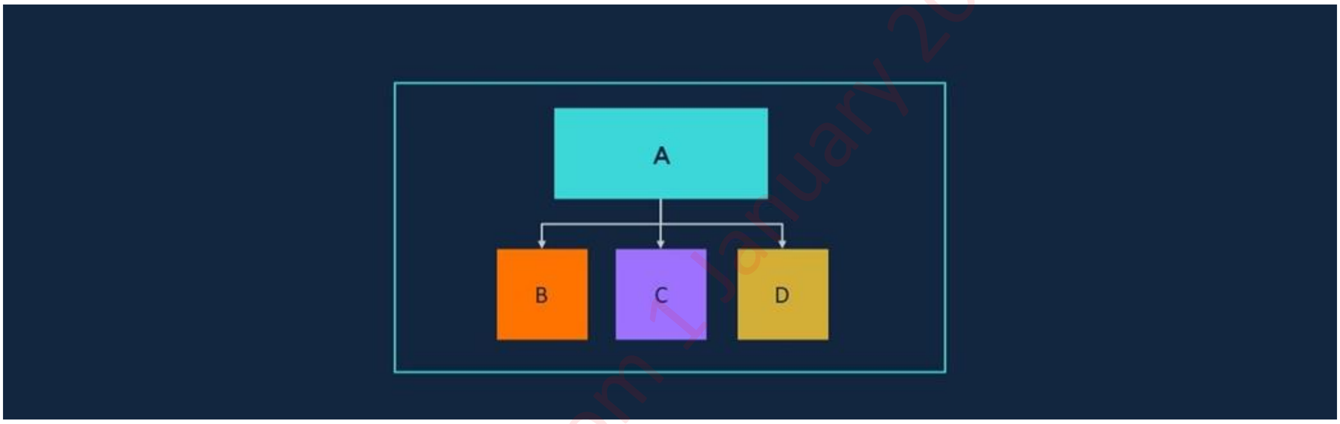
7. Illustrative Scenarios

7.1 The following scenarios illustrate the application of the guidelines on groups of connected clients.

Group of connected clients based on control

Scenario C1: Main Case

7.2 The reporting firm has exposures to entities A, B, C and D. Entity A has control over entities B, C and D. The subsidiaries B, C and D are special purpose entities.



7.3 To assess if there is no single risk despite the existence of a control relationship, the firm may assess the following in relation to each special purpose entities (B, C and D):

a. The absence of economic interdependence or correlation between the credit quality of the parent undertaking A and the credit quality of the special purpose entities (B, C or D). An example of correlation in credit quality would be where the special purpose entities rely on the parent undertaking A for funding, and this prevents them being deconsolidated under the applicable accounting rules.

b. The special purpose entity's bankruptcy remoteness from its parent (defined in 1.3 of the Counter Credit Risk Part of the PRA Rulebook).[2] That is, whether effective arrangements are in place, to ensure that the assets of the special purpose entity will not be available to the creditors of parent undertaking A in the event of A's insolvency.

c. Whether debt securities issued by the special purpose entity reference assets that are third parties' liabilities.

2 Counterparty Credit Risk (CRR) – Application and Definitions – www.prarulebook.co.uk/rulebook/Content/Chapter/403316/05-10-2023.

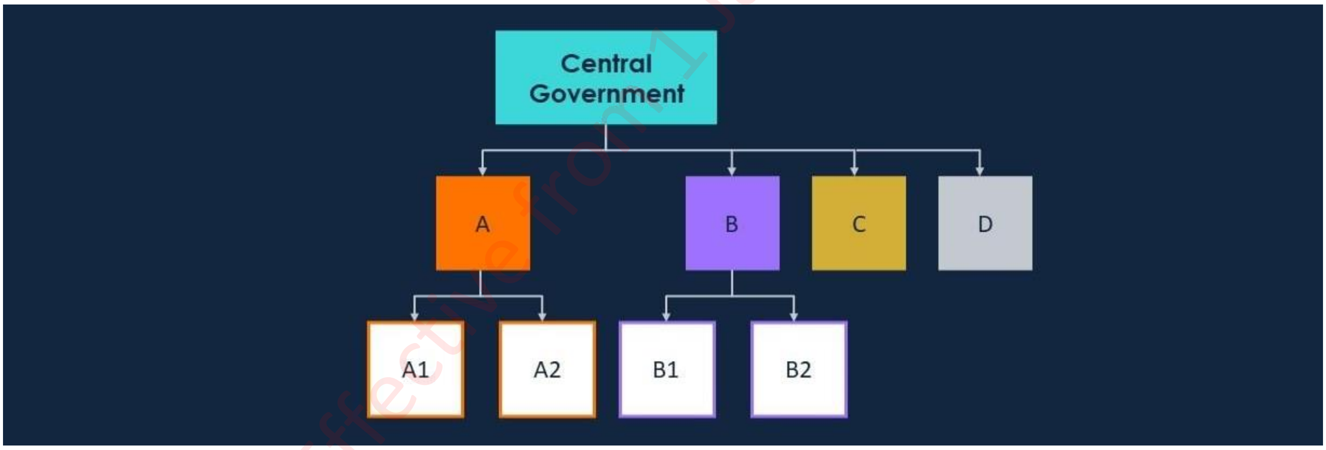
d. The structural enhancement in a securitisation, and the delinkage of the obligations of the special purpose entity from those of the parent undertaking A, such as the existence of provisions in the transaction documentation ensuring servicing and operational continuity.

e. The compliance with the provisions under Article 250 of the CRR regarding 'arm's length' conditions.

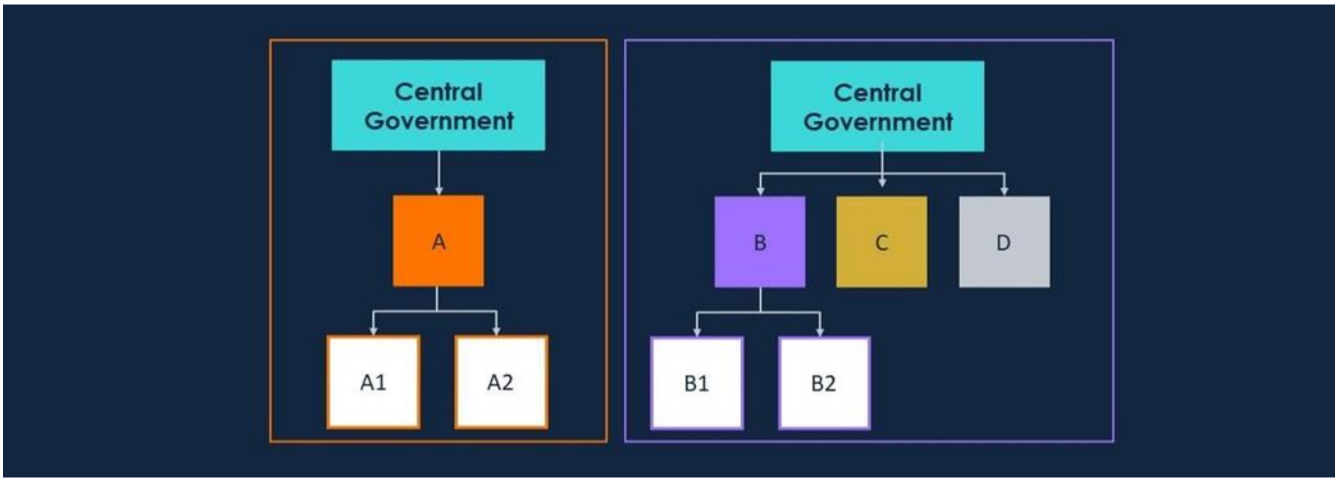
7.4 Having assessed these elements the firm could conclude that, for example, subsidiaries B and C do not constitute a single risk with parent undertaking A. As a result, the firm needs to consider a group of connected clients composed only of clients A and D. The firm should document these assessments.

Alternative approach for exposures to central governments

7.5 To illustrate the possible scenarios, the following general scenario is used: the central government controls four entities (A, B, C and D). Entities A and B in return control two subsidiaries each (A1 and A2, B1 and B2). The firm has exposures to the central government and all the entities shown.

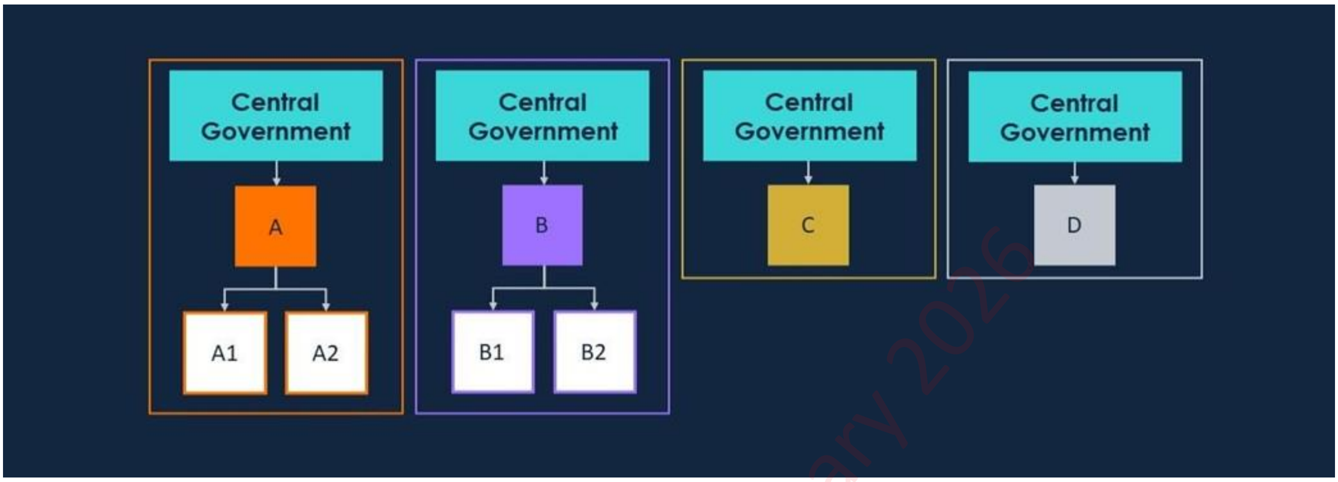


Scenario CG1: Alternative approach – partial use



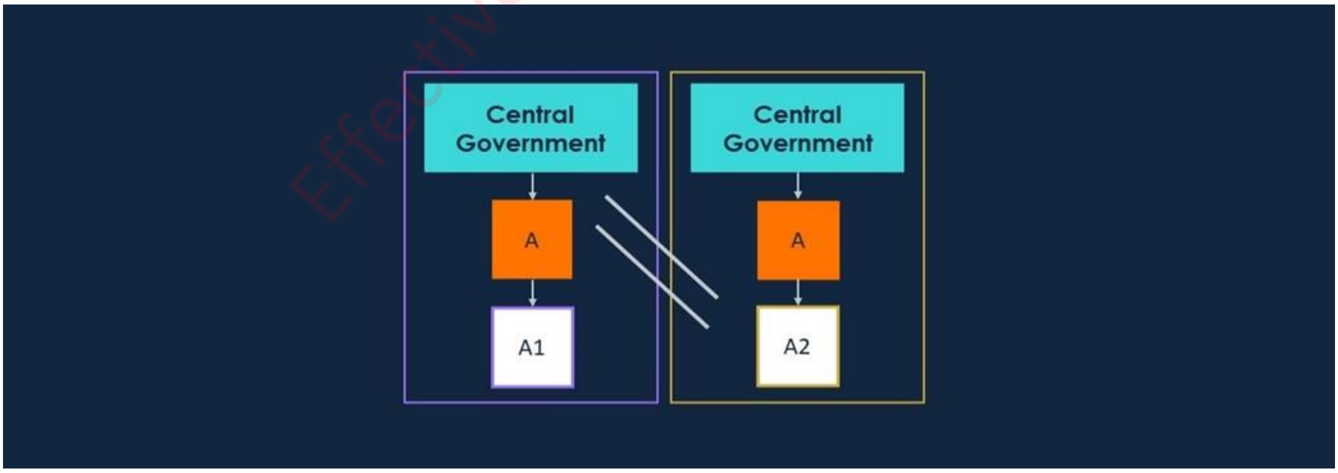
7.6 The firm may decide to form two groups of connected clients. The first including the central government, A, A1 and A2. The second including the central government, B, B1, B2, C and D.

Scenario CG2: Alternative approach – used for all directly dependent entities



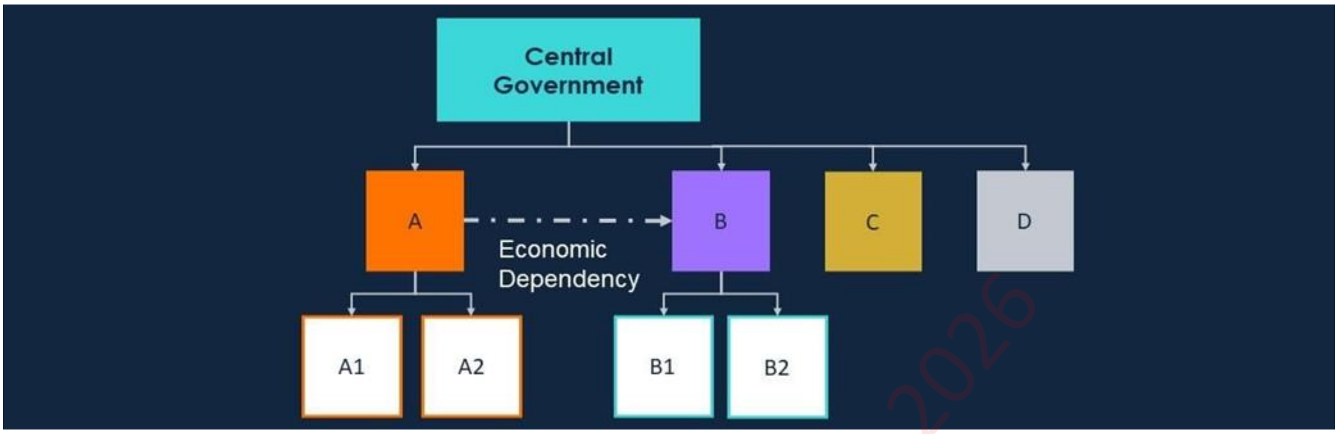
7.7 The firm may also decide to form four separate groups of connected clients for each entity directly controlled by or directly interconnected with the central government. In this example A1, A2, B1 and B2 are indirectly connected via control to the central government and should therefore be included in the group of connected clients containing A and B, respectively.

Scenario CG3: Alternative approach do not apply to exposures to entities indirectly controlled by, or connected to, the central government

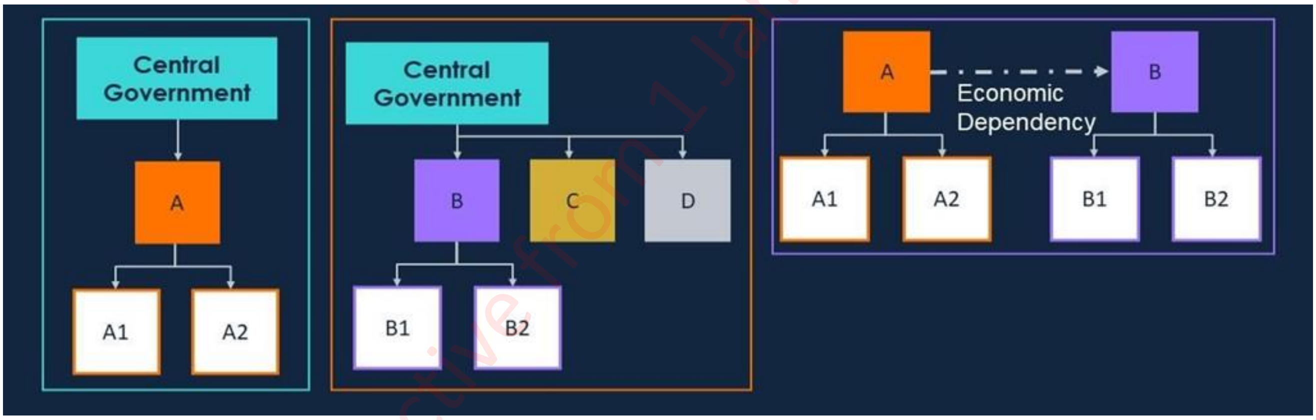


Scenario CG4: 'Horizontal connections'

7.8 Apart from being connected via control to the central government, a firm also determines that entities A and B are economically dependent (payment difficulties for B would affect A):



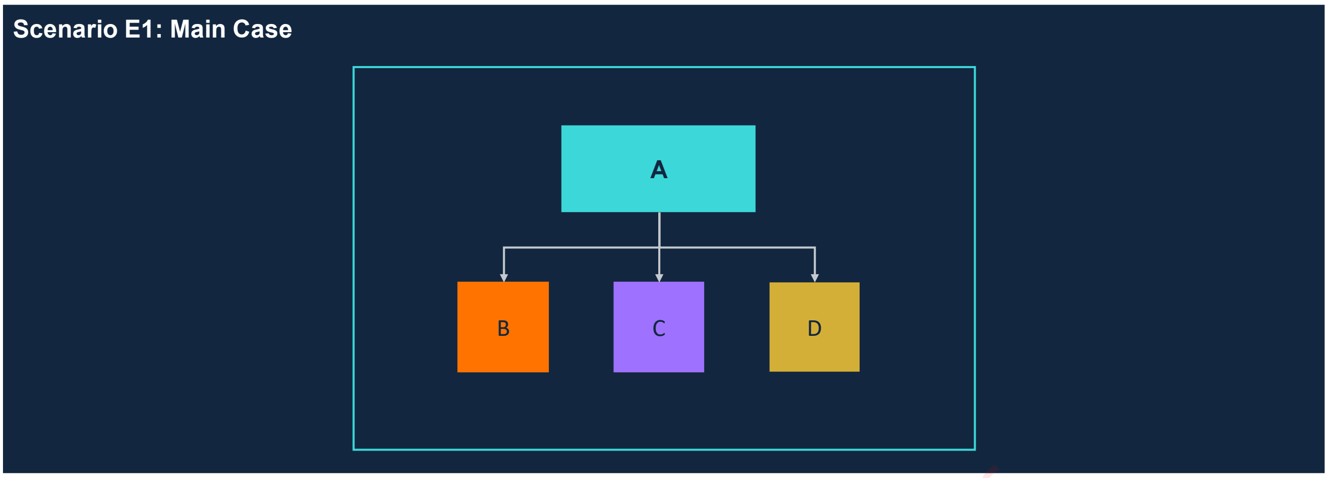
7.9 If the firm uses the alternative approach only in part, as described in scenario CG1, the firm should form a third group of connected clients:



Establishing interconnectedness based on economic dependency

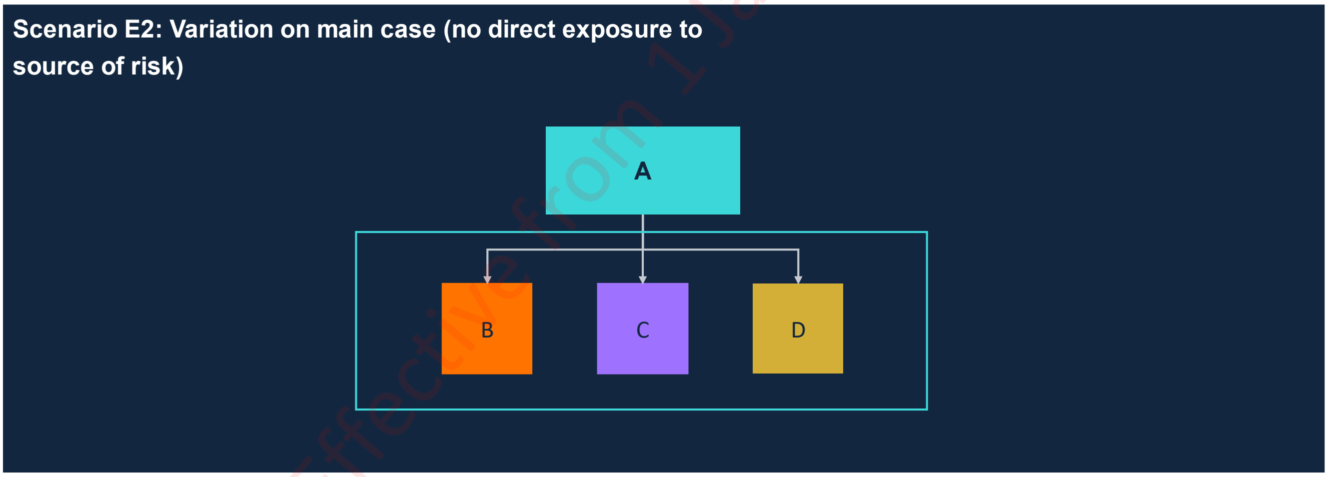
Scenario E1: Economic dependency

7.10 In **Scenario E1** the firm has exposures to all entities shown below (A, B, C and D). B, C and D rely economically on A. The underlying risk factor for all entities is A and the firm should group all entities into a groups of connected clients, not three individual ones (it is irrelevant that there is no interconnection between B, C and D).



Scenario E2: Variation on main case (no direct exposure to source of risk)

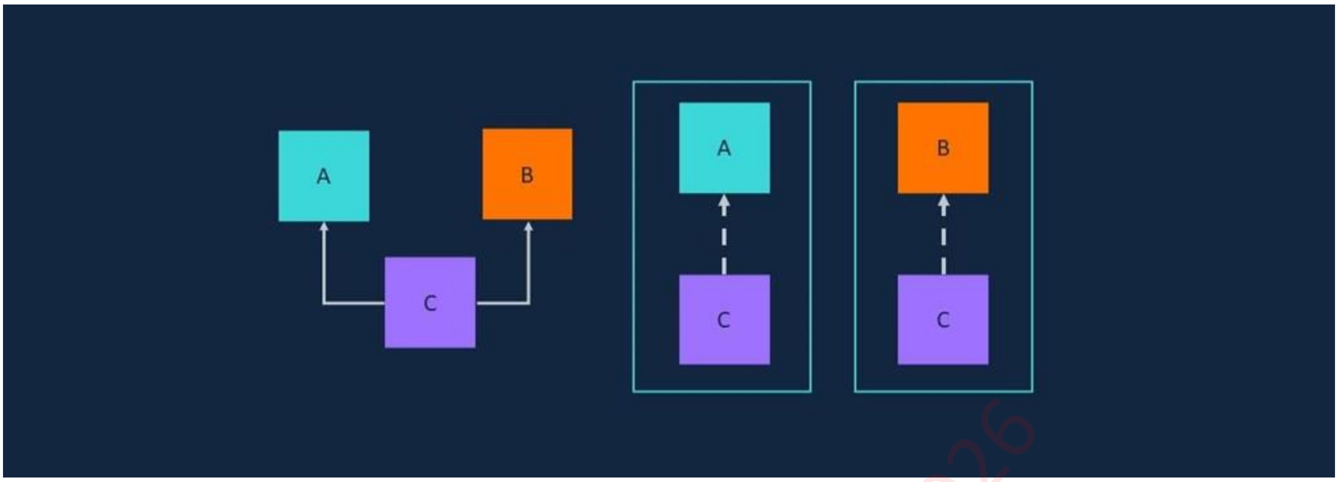
7.11 There is a grouping requirement even if the firm does not have a direct exposure to A but is aware of the economic dependency of each client (B, C and D) on A. If A experiences payment difficulties and it is likely to cause payment difficulties for B, C and D, they should be treated as a single risk. Although A is not a client of the firm and will not be included in a group of connected clients, it is the reason for grouping B, C and D.



Overlapping groups of connected clients

7.12 A reporting firm has exposures to A, B and C. Entity C is dependent on both entity A and B, but they are not dependent on C or on each other. The firm should create two groups of connected clients, one including entity A and C and one including entity B and C.

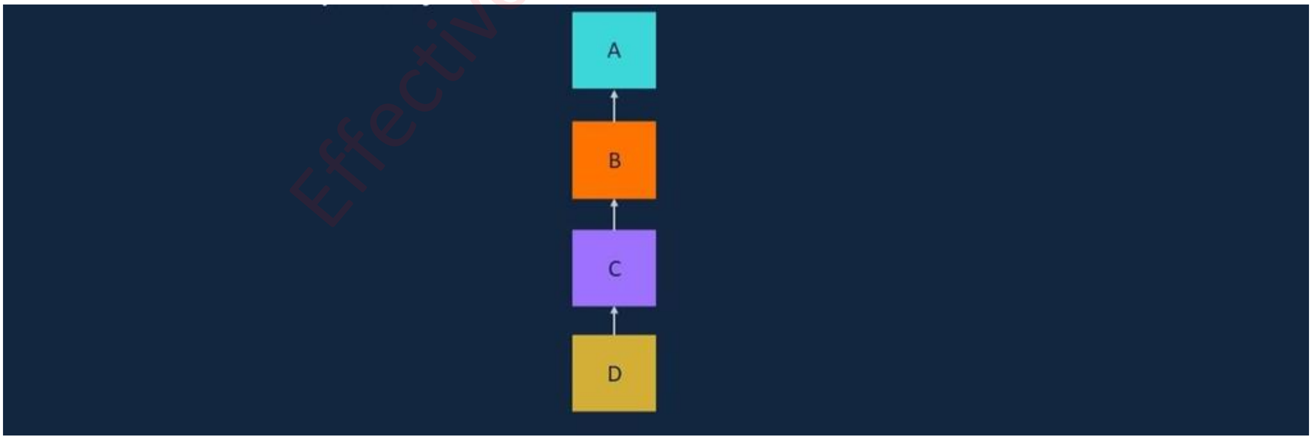
Scenario E3: Overlapping groups of connected clients



7.13 There is no risk that the exposure to C will be double counted, because the exposure to C is considered a single risk in two separate groups. The large exposure limit applies separately (ie the limit applies once to exposures to the group comprising A and C and once to exposures to group comprising B and C). As there is no dependency between A and B and financial difficulties in C do not lead to difficulties in A or B, no comprehensive group (comprising A, B, and C) needs to be formed.

Scenario E4: Chain of Dependency

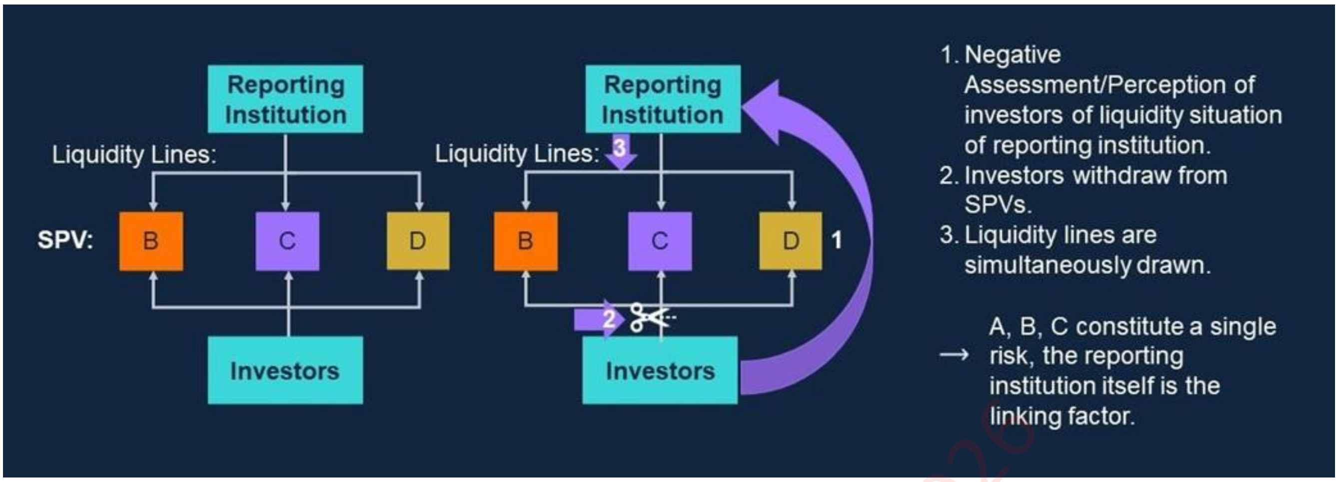
7.14 In the case of a chain of dependency, (eg D is dependent on C, which in turn is dependent on B, which in turn is dependent on A) all entities that are economically dependent (even if the dependency is only one way) need to be treated as one single risk.



Firm as source of funding

7.15 In **Scenario E5**, the reporting firm is the liquidity provider of three special purpose entities or similar structures. If the firm cannot easily be replaced as a source of funding, the special purpose entities should be treated as a single risk.

Scenario E5: Firm as source of funding (grouping)



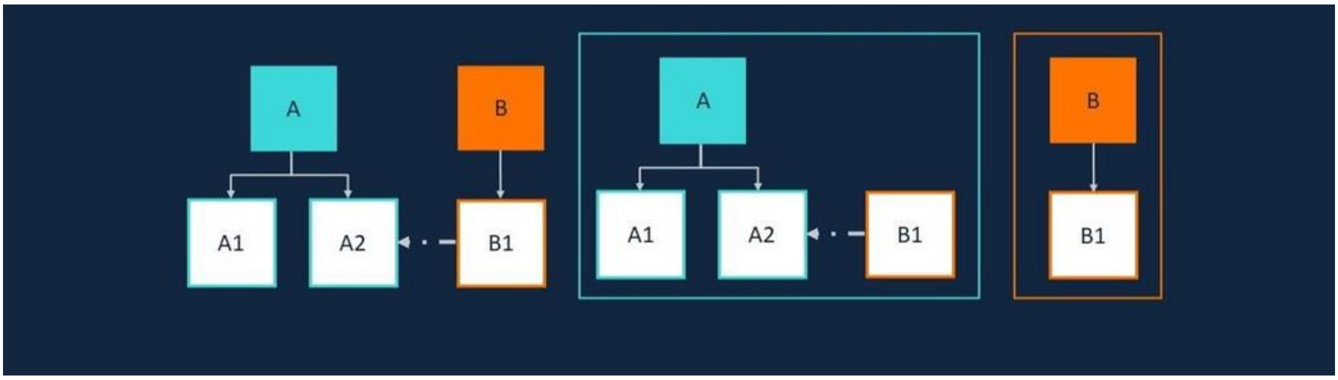
7.16 In the scenario above, it does not make a difference whether the liquidity lines are directly interconnected to the special purpose entities or to underlying assets within the special purpose entities; what matters is the fact that liquidity lines are likely to be drawn on simultaneously.

7.17 Diversification and quality of the assets are also not considerations in this scenario, nor is the reliance on investors in the same sector (eg investors in the ABCP market), as the single risk is created by the use of similar structures and the reliance on commitments from one source (ie the reporting institution as the originator and sponsor of the SPVs).

Relation between interconnectedness through control and interconnectedness through economic dependency

Scenario CE1: Combined occurrence of control and economic dependency (one-way dependency)

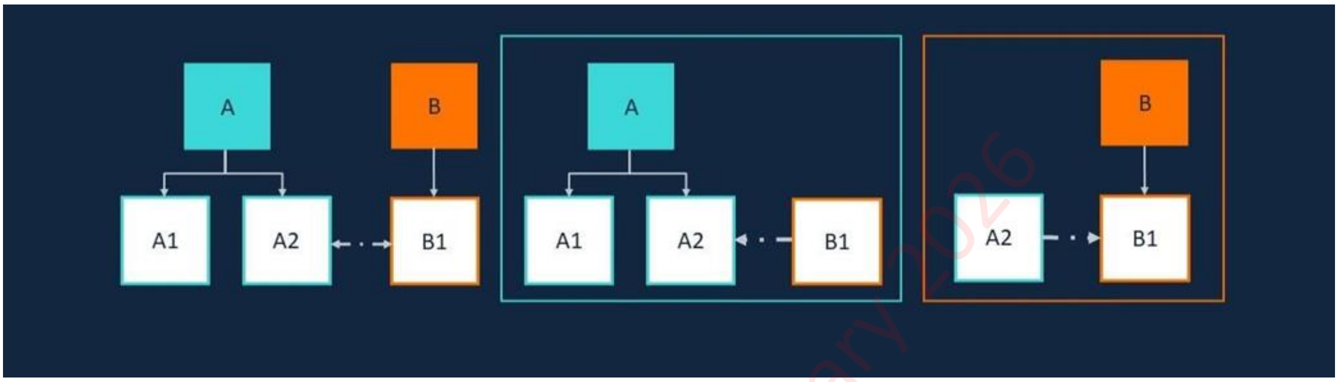
7.18 In **Scenario CE1**, the firm has exposures to all entities shown in the diagram below. A controls A1 and A2, B controls B1. Furthermore, B1 is economically dependent on A2 (one-way dependency).



Grouping Requirement: In this scenario, the firm should include B1 in the group of connected clients of A (consisting of A, A1, A2 and B1) as well as of B (consisting of B and B1).

Scenario CE2: Combined occurrence of control and economic dependency (two-way dependency)

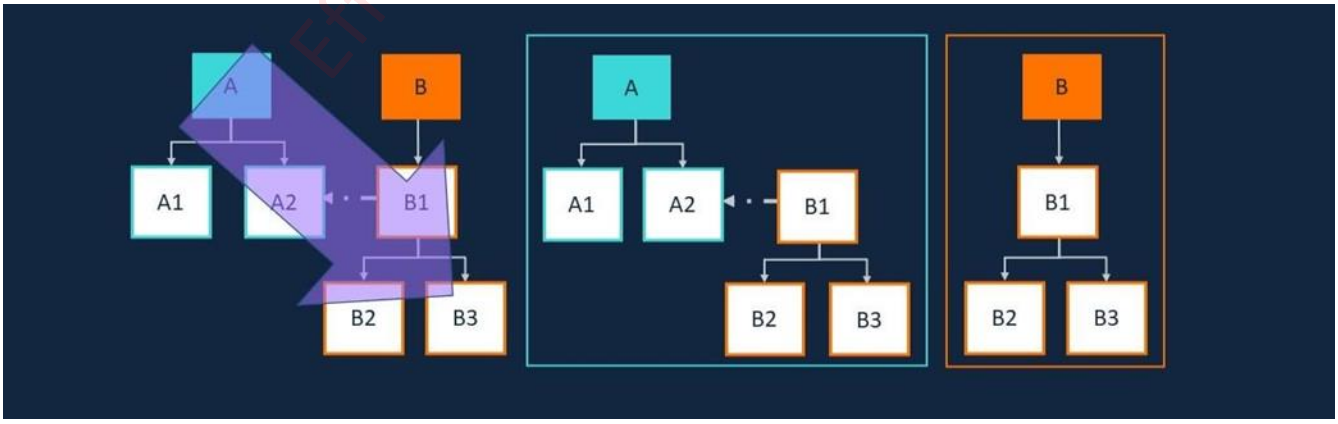
In **Scenario CE2**, A2 and B1 are economically dependent on each other.



Grouping Requirement: The firm should include A2 in the group of connected clients of B (consisting of B, B1 and A2) because financial problems in A2 are likely to lead to financial problems in B and B1. B1 would still need to be included in group A as in the previous scenario.

Scenario CE3: Downstream contagion

7.20 In a variation on scenario CE 2 above, B1 also controls two entities (B2 and B3). In this case, the financial difficulties of A will pass through A2 and B1 down to the two subsidiaries of B1 ('downstream contagion'). This will require B1, B2 and B3 to be included in both group of connected clients of A and the group of connected clients of Group B. B is not included in Group A, as financial difficulties in B1 and below would not lead to financial difficulties in B.



Scenario CE4: Upstream contagion

7.21 If B is, however, economically interconnected to B1, the financial difficulties of A may proceed 'upwards' to B. A firm would have to treat exposures to all A and B entities as a single risk.