

Supervisory Statement | SS17/13

Credit risk mitigation

January 2026

(Updating July 2019)



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Effective from 1 January 2027





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1 Introduction

1.1 The purpose of this SS is to provide clarification to firms of the Prudential Regulation Authority's (PRA) expectations in respect of the recognition of credit risk mitigation in the calculation of certain risk-weighted exposure amounts.

1.2 This Supervisory Statement (SS) applies to PRA-authorised banks, building societies, PRA-designated investment firms, and PRA-approved or PRA-designated financial or mixed financial holding companies (collectively 'firms').

2 Eligibility of protection providers under all approaches

[Deleted]

3 Recognised exchanges

[Deleted]

4 Conditions for applying a 0% voluntary adjustment under the Financial Collateral Comprehensive Method (FCCM)

[Deleted]

5 Permission to use 'own estimates of voluntary adjustments' under the FCCM

[Deleted]

6 Netting of liabilities that may be subject to bail-in

6.1 To qualify as an eligible form of credit risk mitigation under the Credit Risk Mitigation (CRR) Part of the PRA Rulebook, netting agreements must meet a number of conditions, including the conditions that those agreements must be legally effective and enforceable in all relevant jurisdictions. Firms must also obtain an independent, written and reasoned legal opinion or opinions in order to establish whether the above conditions are met.

6.2 The PRA does not consider that netting agreements are legally effective and enforceable where a resolution authority has the power to bail in the liabilities in question on a gross basis and netting of these liabilities will therefore not qualify as an eligible form of credit risk mitigation.

6.3 Conversely, the PRA does not expect that the legal effectiveness and enforceability of a netting agreement is affected where a resolution authority has the power to bail in the liabilities in question only on a net basis.

7 Eligibility of guarantees and credit derivatives as unfunded credit protection

7.1 This chapter is relevant to any firm that is intending to treat an arrangement as a guarantee or credit derivative qualifying as unfunded credit protection under the Credit Risk Mitigation (CRR) Part. It is also relevant to any firm subject to other parts of the PRA Rulebook

and other legislation that cross-refers to relevant provisions in the Credit Risk Mitigation (CRR) Part. This includes, for example, the Large Exposures (CRR) Part and the Securitisation (CRR) Part of the PRA Rulebook.

7.2 The requirements for guarantees and credit derivatives are set out in the Credit Risk Mitigation (CRR) Part. ‘Guarantee’ is not defined in that Part or in CRR. While guarantees can take many forms and be governed by different laws, only those that meet the criteria set out in the Credit Risk Mitigation (CRR) Part are eligible as unfunded credit protection.

7.2A The PRA considers that firms may treat credit insurance (including mortgage indemnity products) as credit risk mitigation provided that the credit insurance can be classified as unfunded credit protection according to the definition in CRR Article 4(1)(59). Firms should treat the credit insurance as a guarantee or a credit derivative depending on whether the credit insurance effectively functions like a guarantee or like a credit derivative respectively.

Legally effective and enforceable (guarantees and credit derivatives)

7.3 Articles 194(1), 194(6)(b), 213(1)(d), and 213(3) of the Credit Risk Mitigation (CRR) Part require that guarantees or credit derivatives must be legally effective and enforceable in all relevant jurisdictions on an ongoing basis. The PRA expects that, at a minimum, this requires a firm to satisfy itself that a guarantee or credit derivative is enforceable under its governing law, and in the jurisdiction where the protection provider is incorporated, and should also include other relevant jurisdictions where enforcement action may be taken. Article 194(2) of the Credit Risk Mitigation (CRM) Part requires that firms take all appropriate steps to ensure the effectiveness of the guarantee or credit derivative. The PRA expects firms to consider the practical ease of enforcement of the guarantee or credit derivative.

Clearly defined and incontrovertible (guarantees and credit derivatives)

7.4 Article 213(1)(b) of the Credit Risk Mitigation (CRR) Part requires that the extent of a guarantee or credit derivative must be clearly defined and incontrovertible. The PRA interprets ‘incontrovertible’ to mean that the wording of the guarantee or credit derivative is clear and unambiguous, and leaves no practical scope for the protection provider to dispute, contest, challenge or otherwise seek to be released from, or reduce, their liability. When satisfying themselves that a guarantee or credit derivative is ‘incontrovertible’, firms should consider the terms of the guarantee or credit derivative itself and the remedies available under the law that applies to that guarantee or credit derivative.

Without any clauses that will render the guarantee ineligible for credit risk mitigation (guarantees)

7.5 Under Article 213(1)(c) of the Credit Risk Mitigation (CRR) Part, some types of clauses will render a guarantee ineligible. The PRA expects that the prohibition on a guarantee containing a clause that prevents the guarantor from being obliged to pay out in a timely manner should, subject to Article 215(2) of the Credit Risk Mitigation (CRR) Part, be read with the further condition in Article 215(1)(a) of the Credit Risk Mitigation (CRR) Part that the firm must have the right to pursue, in a timely manner, the guarantor for any monies due under the guarantee, and the further condition in Article 215(1)(aa) of the Credit Risk Mitigation (CRR) Part that payment shall not be subject to the firm first having to pursue the defaulting obligor for recovery. The PRA expects firms to review agreements to ensure that they do not contain such clauses.

Exclusion of certain types of payments and limited coverage (guarantees)

7.6 Article 215(1)(c) of the Credit Risk Mitigation (CRR) Part requires that a guarantee must cover all types of payments the obligor is expected to make to the firm or, where certain types

of payment are excluded from the guarantee, that the firm has adjusted the value of the guarantee to reflect the limited coverage. When considering whether ‘certain types of payment’ are excluded from the guarantee, the PRA expects firms to consider the different sums the obligor may be required to pay to the firm under the contract, such as principal, interest, margin payments, fees, and charges. For example, the firm contemplates a guarantor guaranteeing non-payment of principal, but not interest payments due by the obligor, or both principal and interest payments, but not fees or other charges. The PRA expects firms to quantify the portion of the exposure that may be affected by this ‘limited coverage’ for the purpose of adjusting the value of the guarantee in accordance with Article 215(1)(c)(ii) of the Credit Risk Mitigation (CRR) Part and calculating the value of unfunded credit protection in accordance with Article 233 of the Credit Risk Mitigation (CRR) Part.

Risks arising from eligible guarantee and credit derivative arrangements

7.7 Article 194(8) of the Credit Risk Mitigation (CRR) Part requires that a firm recognising credit risk mitigation must be able to demonstrate that it has adequate risk management processes to control risks to which it may be exposed as a result of carrying out credit risk mitigation practices. Article 213(3) of the Credit Risk Mitigation (CRR) Part requires that a firm must fulfil any contractual and statutory requirements in respect of, and take all necessary steps to ensure, the enforceability of its unfunded credit protection. In relation to guarantees or credit derivatives intended to qualify as credit risk mitigation, the PRA expects firms to identify risks arising from guarantee or credit derivative arrangements. This includes identifying the risk that the firm does not fulfil an obligation or term which could render the credit protection ineffective. Examples of such obligations or terms include maintaining an uninsured percentage of the risk, paying premiums on time and disclosing material information to the protection provider. Firms are expected to have adequate risk management processes in place to control these risks.

Residual risks

7.8 [Deleted]

Pillar 2 (guarantees and credit derivatives)

7.9 The expectations set out in this chapter relate to the eligibility of guarantees and credit derivatives as credit risk mitigation in Pillar 1 of a firm’s capital requirements. Guarantees and credit derivatives that do not meet these expectations should not be recognised in Pillar 1.

7.10 Paragraph 7.9 does not preclude the possibility that holding additional capital under Pillar 2 may be necessary where a guarantee or credit derivative is eligible under Pillar 1. This may be appropriate in a number of circumstances, including where there are residual risks and a firm is applying either the Risk Weight Substitution Method or the Parameter Substitution Method. As noted in SS31/15 ‘The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)’,¹ the SREP will specifically consider firms’ management of residual risk from the use of credit risk mitigation techniques.

7.11 [Deleted]

8 Eligibility of financial collateral where there is a correlation between the collateral value and the credit quality of the obligor

8.1 This chapter is relevant to any firm that wishes to recognise the effects of financial collateral under the Credit Risk Mitigation (CRR) Part. It is also relevant to any firm subject to

¹ <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss>.

other parts of the PRA Rulebook, the CRR, and other legislation that cross-references to relevant provisions in the Credit Risk Mitigation (CRR) Part.

Requirements relating to correlated collateral

8.2 In accordance with Article 207(2) of the Credit Risk Mitigation (CRR) Part, in order for financial collateral to be an eligible credit risk mitigant, the credit quality of the obligor and the value of the collateral must not have a material positive correlation. Any financial collateral asset whose value is materially positively correlated with the obligor's credit quality is not eligible, as it cannot be relied upon to mitigate loss at the point of default.

8.3 In determining whether a financial collateral asset satisfies the requirement in Article 207(2) of the Credit Risk Mitigation (CRR) Part, the PRA expects firms to consider the characteristics of the obligor, the transaction and the collateral. Relevant characteristics will vary depending on the transaction but might include legal connectedness, business model dependencies, correlations that might arise where the obligor and the collateral issuer share the same country, and any other relevant characteristics.² In each case the firm should consider whether the relevant characteristics might, either on their own or in combination with other relevant characteristics, give rise to a material positive correlation between obligor creditworthiness and collateral value such that the collateral might not provide effective mitigation at the point of obligor default. The PRA considers that the absence of a legal connection between the issuer of the collateral and the obligor does not preclude the possibility of material positive correlation.

Material positive correlation in transactions with limited recourse

8.4 In the context of transactions where the lender has no or limited recourse to other assets beyond the financial collateral assets, a fall in the value of the financial collateral assets may itself sometimes trigger the default of the obligor. Subject to paragraph 8.5A, the PRA considers that any financial collateral asset whose value has a material positive correlation with the total value of all of the assets to which the lender has legal recourse (including collateral posted by the obligor and any other assets to which the firm has legal recourse)³ would meet the definition of material positive correlation set out in Article 207(2) of the Credit Risk Mitigation (CRR) Part.⁴

8.5 The PRA provides two examples:

- (i) a non-recourse margin loan is a margin loan made to an obligor whereby the lender has legal recourse only to the posted collateral and not to the obligor's other assets. Any individual financial collateral asset whose value is materially positively correlated with the total value of all the collateral assets securing such a loan should be considered ineligible under Article 207(2) of the Credit Risk Mitigation (CRR) Part. Consequently, the PRA expects that non-recourse margin loan collateral assets that consist of a single asset, or group of materially positively correlated assets, should be considered to be ineligible collateral; and
- (ii) a non-recourse margin loan may also be structured as a loan to a special purpose entity (SPE) whose assets consist primarily, or entirely, of the collateral posted to the lender(s). In

² Where the obligor and the collateral issuer share the same country, this does not necessarily imply there is a material positive correlation.

³ This would include all of the unencumbered assets of the obligor if the lender has a general recourse to the obligor, and may also include assets of a third party where that third party has provided a legally enforceable guarantee.

⁴ Where a financial collateral asset is an index instrument, a firm may consider each constituent asset of the index as a separate financial collateral asset for the purposes of this paragraph.

this case any individual financial collateral asset whose value is materially positively correlated with the total value of all the SPE's assets should be considered ineligible under Article 207(2) of the Credit Risk Mitigation (CRR) Part. For the avoidance of doubt, an expectation of financial support from the SPE sponsor should not be considered an asset of the SPE for these purposes.

8.5A The PRA considers that financial collateral assets referred to in paragraph 8.4 may not necessarily meet the definition of material positive correlation set out in Article 207(2) of the Credit Risk Mitigation (CRR) Part in the following circumstance: The transaction is structured so that the exposure value directly depends on the collateral value in such a way that the collateral value to exposure ratio (C/E) does not fall if the collateral value (C) falls where:

- E = the exposure value before taking into account the effects of the collateral; and
- C = collateral value.

8.6 The PRA expects firms using the 'LGD Modelling Collateral Method' in accordance with Article 169A of the Credit Risk: Internal Ratings Based Approach (CRR) Part of the PRA Rulebook, or using the Internal Model Method (IMM), not to recognise collateral received which has a material positive correlation as described in paragraphs 8.4 and 8.5.

8.7 Under the Securitisation (CRR) Part, an originator may seek to recognise credit risk mitigation obtained in respect of a synthetic securitisation position provided by a securitisation special purpose entity (SSPE). As the originator has recourse to the reference obligations in the reference portfolio in addition to the assets of the SSPE, paragraph 8.4 may not be relevant. However, in so far as any financial collateral assets held by the SSPE are required to be eligible under the Credit Risk Mitigation (CRR) Part, firms should apply Article 207(2) of that Part, taking into account the extent of any correlation between the reference obligations in the reference portfolio and the assets of a SSPE.

9 Eligibility of non-financial collateral under the Standardised Approach

9.1 Firms using the standardised approach are not permitted to treat non-financial collateral as eligible collateral when recognising CRM in accordance with the methods set out in the Credit Risk Mitigation (CRR) Part. The PRA expects, however, that firms using the standardised approach should reflect the existence of non-financial collateral in their assignment of risk weights, where relevant, in line with the provisions of the Credit Risk: Standardised Approach (CRR) Part.

10 Obligor grade adjustment in IRB models

10.1 Firms using the internal ratings based (IRB) approach for exposures to corporates and institutions may reflect support arrangements by adjusting obligor grades in accordance with Article 172(1)(e) of the Credit Risk: Internal Ratings Based Approach (CRR) Part. This approach is not however available where the support arrangements are recognised by a firm using the LGD Adjustment Method as set out in Article 171(3)(b) of the Credit Risk: Internal Ratings Based Approach (CRR) Part.

11 Funded credit protection securing unfunded credit protection obligations

11.1 In accordance with Article 191A(2)(f) of the Credit Risk Mitigation (CRR) Part, if a firm chooses to recognise the effect of funded credit protection securing unfunded credit protection obligations, any references to the ‘borrower’ or ‘obligor’ within each collateral eligibility requirement are deemed to have a specific meaning that reflects the purpose of that eligibility requirement. In particular, the PRA expects that:

- (a) in cases where the collateral eligibility requirements in the Credit Risk Mitigation (CRR) Part refer to the borrower or obligor in their role as the entity providing the collateral, these references should be read to refer to the unfunded credit protection provider (for example in Article 212(1)(a) of the Credit Risk Mitigation (CRR) Part);
- (b) in cases where the collateral eligibility requirements in the Credit Risk Mitigation (CRR) Part refer to the default of the borrower or obligor as a trigger for the firm to take control of and then liquidate the collateral, these references should be read to refer to the event of default of both the obligor and the protection provider (for example in the first sentence of Article 194(4) of the Credit Risk Mitigation (CRR) Part); and
- (c) in cases where the collateral eligibility requirements in the Credit Risk Mitigation (CRR) Part refer to a correlation between the value of the collateral and the credit quality of the borrower or obligor, these references should be read to also include the unfunded credit protection provider where the firm recognises both the funded credit protection and the unfunded credit protection (for example in the second sentence of Article 194(4) of the Credit Risk Mitigation (CRR) Part). If a firm recognises only the funded credit protection (and not the unfunded credit protection), then these references should not be read to include the unfunded credit protection provider. This means that firms that recognise unfunded credit protection cannot also recognise funded credit protection where there is either a material positive correlation between the value of the collateral and the credit quality of the obligor or a material positive correlation between the value of the collateral and the credit quality of the protection provider.

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