Content of question:
When shall a liable entity implementing the IRB Approach calculate a capital requirement for dilution risk of purchased receivables in the investment portfolio? **Under which conditions is it possible to deem dilution risk immaterial and, therefore, not to calculate the capital requirement?** **Which parameters for calculating the capital requirement for dilution risk within the IRB Approach shall be used in such case?**
Answered by: **Helena Sůvová** Approved by: **Pavel Vacek** Date: **20 December 2007**

Piece of law	**Decree No. 123/2007 Coll. (hereinafter the "Decree")**
Provision	**Article 95, 3** **Annex 12, 6, b)**
Explanation	Article 75 of the Decree stipulates that the capital requirement for credit risk includes, among others, a capital requirement for dilution risk in the investment portfolio. In case the liable entity intends to implement the IRB Approach Article 95, 3 stipulates that the risk-weighted exposure amount for dilution risk is set for purchased receivables. It follows that if the liable entity holds purchased receivables in its portfolio it calculates the relevant capital requirement unless this risk is eliminated by the liable entity through full recourse to the seller of these receivables. Additionally, the above mentioned provision of Annex 12 to the Decree implies that the possibility of an immaterial amount of risk remaining with the liable entity is admitted, however, the liable entity is assumed to have essentially eliminated this risk and it is, therefore, immaterial from this point of view. It can be generally stated that **immateriality** within the meaning of the Decree is assessed in terms of the **amount of risk, not** in terms of the current **size of the portfolio** of purchased receivables. The second part of the question relates to the method for calculating the capital requirement for dilution risk. The values of the input parameters for a calculation within the IRB Approach are determined in Annex 12, 1, b), Annex 12, 2, e), Annex 13, I, 1, f) (purchased corporate receivables) and I, 2, c) (purchased retail receivables). It can be stated in general that if the liable entity is capable of estimating individual PDs and LGDs of these receivables (i.e. the liable entity knows their obligors) it shall use these individual parameters, given that if the liable entity is not entitled to use its own estimates for LGDs (the FIRB Approach) the minimum LGD equals 75%. However, if the liable entity is unable to decompose reliably its expected loss estimates into PDs and LGDs it shall

	determine the expected loss for dilution risk and set PD equal to this loss. In such case LGD is equal to 100%. The value of M for dilution risk 1 year. In the case of purchased corporate receivables the liable entity can also recognise unfunded credit protection in the risk parameters, as long as the protection meets the eligibility criteria (e.g. recourse to the receivables' seller).