

Content of question – The use of preferential risk weights under the Standardised Approach

Piece of law	Decree No. 123/2007 Coll. (as amended) (hereinafter the "Decree")
Provision	• Art. 88; Annex 4, 1
Question	Is it always obligatory for the liable entity to utilise the provision of Annex 4, 1, e to the Decree and apply a preferential risk weight to exposures to central governments and central banks of the EEA Member States (hereinafter " Member States") denominated and funded in their domestic currency, or is it possible to use the external credit assessment based method pursuant to Annex 4, 1, c, if the liable entity considers such approach to be more prudent and better capturing the risk profile of the exposure (e.g. in the case of exposures to the government of Greece)?
Answer	<p>The provision of Annex 4, 1, e, which enables to assign a preferential risk weight to exposures to central governments and central banks of Member States denominated and funded in their domestic currency, represents a transposition of Directive 2006/48/EC. At the time of its adoption there was a general assumption that exposures to Member States carry a very low amount of risk. This provision has not changed and, therefore, it does not facilitate to respond to changed conditions arising from the economic crisis, which is one of the distinctive features between the STA and IRB Approaches.</p> <p>The use of a preferential risk weight can be understood as an option the utilisation of which should be supported by the bank's own analysis as well, and not as an obligation. It is desirable that the liable entity assess whether the associated risk weight corresponds to the risk profile of the exposure (such approach is in agreement with the latest proposals of the Basel Committee on Banking Supervision). One must bear in mind that the risk weight pursuant to Art. 88, 1 is primarily based on, along with the assignment of the exposure to a class, an assessment of the credit quality of the exposure. It is thus possible to risk-weight the exposure in question pursuant to Annex 4, 1, c.</p> <p>Additionally, a general rule is that if a risk weight for the purpose of determining a capital requirement pursuant to Annex 4 to the Decree has been determined in a manner that is non-preferential but also not entirely reflecting the actual risk profile of the exposure, the liable entity must reflect the actual risk profile of the exposure in its internal capital pursuant to Art. 12c of the Act on Banks, or Art. 8a of the Act on Credit Unions, or Art. 9a of the Act on Business Activities on the Capital Market.</p>
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Further information for the recipient of the answer:	The answer reflects views of the staff members of the Czech National Bank. A court of law, or possibly the Bank Board of the Czech National Bank, may take a different point of view. However, a liable entity's practices that adhere to the answer will be considered, within the limits of the answer and its assumptions, to be in harmony with legal regulations, unless the inapplicability of the answer to the case in question follows from circumstances particular to the case.