

Content of question:

Is it possible to regard the cession of, or the pledge on, receivables towards a selected group of sub-debtors only (a concentration occurs) as eligible credit protection if ratings of these sub-debtors are available and these ratings are of a satisfactory level?

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Approved by: **Pavel Vacek**

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Piece of law	<b>Decree No. 123/2007 Coll. (as amended)</b>
Provision	<b>Annex 15, A, II, 2, b), 6</b> <b>Annex 15, A, II, 2, b), 4</b>
Explanation	<p>The requirement for the diversification of receivables accepted as collateral laid down by the Decree does not take into account the existence of internal ratings. The Decree only deals with the issue of a positive correlation between the value of the receivable and the credit quality (rating) of the obligor. The Decree does not impose, even in the case of the IRB Approach, any requirement to determine an internal rating of the receivable's obligor (sub-debtor). However, it can be concluded from the general principles for credit risk management that it is desirable for the purpose of capturing all of the undertaken risk that the liable entity monitor the economic sector and the main data on the financial and economic situation of the sub-debtors [see also, for example, the requirements in Annex 15, A, II, 2, b), 4].</p> <p>In case the liable entity determines internal ratings of its sub-debtors it can be deemed an advantage. However, its internal procedures must take account of the arising concentration risk and the sub-debtors' internal ratings can be utilised in this connection. Additionally, the use of internal ratings in various processes in the bank is part of the so-called use test and, therefore, part of the validation of the IRB model by a competent authority.</p> <p>In addition to the number of the sub-debtors, concentration is also assessed from the point of view of materiality, i.e. the amount of the exposures protected in this manner. A higher degree of concentration in itself does not necessarily entail complete ineligibility of the protection in question; however, the lack of diversification must be reflected in determining the recognised value of such protection.</p>