

MEMO

**DANISH FINANCIAL
SUPERVISORY AUTHORITY**

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Banking Division 1
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Number-weighted LGD and CF estimates in the IRB Approach

According to Article 181(1)(a) in the CRR-regulation¹ an authorized IRB institution using own LGD estimates for each facility rating class or pool must estimate LGD based on average realized LGD values for the relevant facility rating class or pool.

The Danish FSA is of the opinion that LGD estimates must be number-weighted. Following discussions with an IRB institution on the feasibility of using exposure-weighted LGD estimates, the FSA had submitted a query to the other European supervisory authorities for their assessment of whether the rules may allow usage of exposure-weighted LGD estimates. The conclusion of the query was clear. The other European supervisory authorities considered the use of exposure-weighted LGD estimates as non-compliant.

That is why the FSA is of the opinion that IRB institutions shall apply number-weighted LGD estimates.

The FSA is also of the opinion that the formulation according to Article 182(1)(a) in the CRR relating to CF estimates is equivalent to that under Article 181(1)(a) in the CRR concerning LGD estimates. Therefore, institutions must use number-weighted CF estimates.

¹ REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.