

**PRA STANDARDS INSTRUMENT: TECHNICAL STANDARDS (ECONOMIC DOWNTURN)
INSTRUMENT 2021**

Powers exercised

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of powers under section 138P (Technical Standards) in the Financial Services and Markets Act 2000 (“the Act”).
- B. For the purposes of section 138P of the Act, the powers to make technical standards which the PRA relies on are conferred on the PRA by Articles 181(3) and 182(4) of Regulation (EU) 575/2013.
- C. The powers referred to above are specified for the purpose of section 138Q(2) (Standards instruments) of the Act.

Pre-conditions to making

- D. The FCA has been consulted on this instrument pursuant to section 138P(4) of the Act and has consented to this instrument pursuant to section 138P(3) of the Act.
- E. In accordance with section 138J of the Act, the PRA published a draft of the proposed instrument and had regard to representations made.
- F. A draft of this instrument has been approved by the Treasury, as required by section 138R of the Act.

Commencement

- G. This instrument comes into force on 1 January 2022.

Citation

- H. This instrument may be cited as the PRA Standards Instrument: Technical Standards (Economic Downturn) 2021.

By order of the Prudential Regulation Committee

18/10/2021

1 DEFINITIONS

1.1 In this Instrument, the following definitions shall apply:

(1) *CRR*

means 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 as it forms part of retained EU law

(2) *exposures to corporates*

means exposures to corporates as referred to in Article 147(2)(c) of the *CRR*

(3) *exposures to institutions*

means exposures to institutions as referred to in Article 147(2)(b) of the *CRR*

(4) *residential property*

has the meaning set out in Article 4(1)(75) of the *CRR*

(5) *retail exposures*

means retail exposures as referred to in Article 147(2)(d) of the *CRR*

(6) *specialised lending exposures*

means specialised lending exposures as referred to in Article 147(8) of the *CRR*

(7) *type of exposures*

has the meaning set out in Article 142(1)(2) of the *CRR*

1.2 Unless otherwise defined, any italicised expression used in this Instrument and in the *CRR* has the same meaning as in the *CRR*.

2 SPECIFICATION OF NATURE, SEVERITY AND DURATION OF AN ECONOMIC DOWNTURN

2.1 For the purposes of Article 181(1)(b) and 182(1)(b) of the *CRR*, an economic downturn shall be identified for each *type of exposures*.

2.2 In identifying an economic downturn for a given *type of exposures*, the following specification rules shall apply:

(1) the nature of an economic downturn is characterised by a set of economic indicators that are classified as relevant for exposures within that *type of exposures* in accordance with 3.1 and 3.2 ('the relevant indicator set');

(2) in terms of severity, an economic downturn is indicated by the most severe value relating to a 12-month period ('the most severe 12-month value') that is observed, for each economic indicator in the relevant indicator set, over a historical time-span determined for that economic indicator in accordance with 4.1 ('the applicable time-span');

(3) an economic downturn is comprised of one or more distinct downturn periods covering the peaks and troughs related to the most-severe 12-month values for the economic indicators in the relevant indicator set, each such period being of a duration determined in accordance with 5.1 ('the duration of a downturn period').

- 2.3 For the purposes of 2.2(2), the 12-month periods to which values for an economic indicator relate may start at any point in time within the applicable time-span.
- 2.4 For the purposes of 2.2(3):
- (1) a downturn period is a period in which an economic indicator reaches its most severe 12-month value;
 - (2) where, for different economic indicators, the peaks or troughs related to the most severe 12-month values are reached simultaneously or shortly after each other, the downturn periods in which those indicators reach their most severe 12-month value are to be treated as one single downturn period covering the most severe 12-month values for all those indicators.

3 RELEVANT INDICATOR SET

- 3.1 The following economic indicators shall be classified as relevant for exposures within a given *type of exposures* where this would not incur disproportionate costs:
- (1) for all *types of exposures*:
 - (a) gross domestic product;
 - (b) unemployment rate;
 - (c) externally provided aggregate default rates, where available;
 - (d) externally provided aggregate credit losses, where available;
 - (2) in addition to the economic indicators listed in 3.1(1):
 - (a) for *exposures to corporates*: relevant sector-specific indices or relevant industry-specific indices;
 - (b) for *retail exposures* to small and medium-sized enterprises: relevant sector-specific indices or relevant industry-specific indices;
 - (c) for *exposures to corporates* secured by *residential property* collateral and for *retail exposures* secured by *residential property* collateral: house prices or house price indices;
 - (d) for *exposures to corporates* secured by commercial immovable property collateral and for *retail exposures* to small and medium-sized enterprises secured by commercial immovable property collateral: commercial immovable property prices or commercial immovable property price indices, and commercial immovable property rental prices or commercial immovable property rental price indices;
 - (e) for *retail exposures* other than those falling within point (b), (c) or (d): total household debt and disposable personal income, in each case where available;
 - (f) for *specialised lending exposures*:
 - (i) in the case of income-producing real estate: immovable property prices or immovable property price indices, immovable property rental prices or immovable property rental price indices, for residential, commercial or industrial property as applicable;
 - (ii) in the case of project finance: prices for the underlying products supplied;
 - (iii) in the case of object finance: indices for the relevant type or types of collateral;

- (iv) in the case of commodity finance: prices or price indices for the relevant type of commodity;
 - (g) for *exposures to institutions*: financial credit indices;
- (3) in addition to the economic indicators listed in points 3.1(1) and (2) as measured in accordance with 3.4, any measures of these or other economic indicators that are explanatory variables for, or indicators of, the economic cycle specific to exposures in the *type of exposures* under consideration.
- 3.2 The economic indicators identified for exposures within a *type of exposures* in accordance with 3.1 shall reflect the geographical distribution and, where applicable, the sectoral distribution of the exposures within that *type of exposures*. For this purpose, an economic indicator shall be included in the relevant indicator set:
 - (1) once for each jurisdiction or, where appropriate, once for each geographical area within a jurisdiction, covered by a material share of that *type of exposures*; and
 - (2) once for each sector, where applicable, covered by a material share of that *type of exposures*.
- 3.3 Where economic indicators to be included in accordance with 3.1(2) show strong co-movement across the different jurisdictions or, as applicable, different sectors, a common economic indicator may instead be selected to reflect those jurisdictions or sectors overall.
- 3.4 For the purpose of 3.1(1) and (2), the relevant economic indicators must be measured in the way that gives the best indicator of economic conditions from one of:
 - (1) the level of the relevant economic indicator;
 - (2) absolute changes in the level of the relevant economic indicator; or
 - (3) percentage changes in the level of the relevant economic indicator.

4 DETERMINING THE APPLICABLE TIME-SPAN

- 4.1 For the purposes of 2.2(2), the historical time-span applicable to an economic indicator shall be sufficient to provide values that are representative of the likely range of variability of that indicator in the future, and shall in any event have a duration of at least twenty years.

5 DURATION OF A DOWNTURN PERIOD

- 5.1 For the purposes of 2.2(3), the duration of a downturn period shall be determined as follows:
 - (1) in a case falling within 2.4(2), the single downturn period shall be a period that is long enough to cover all the peaks or troughs related to the most severe 12-month values observed for the different economic indicators associated with that single downturn period;
 - (2) in all cases, whether or not falling within 2.4(2), where the various 12-month values observed for the economic indicator or indicators in question over the applicable timespan do not significantly deviate from their most severe 12-month value over a specific, continuous period of time within the applicable time-span, the downturn period shall be long enough to reflect the prolonged severity observed for the economic indicator or indicators in question;
 - (3) in all cases, whether or not falling within 2.4(2), where:

- (i) the economic indicator or indicators show adjacent peaks or troughs to the peaks or troughs related to the most severe 12-month values observed for the economic indicator or indicators in question over the applicable time-span,
- (ii) the adjacent peaks and troughs do not significantly deviate from the most severe 12-month value observed for that indicator or those indicators over that time-span, and
- (iii) the adjacent peaks and troughs are related to the same overall economic condition,

the downturn period shall be long enough to reflect the whole prolonged period over which the adjacent peaks or troughs are observed;

- (4) where neither (1), (2) or (3) apply, the downturn period shall be the 12-month period to which the most severe 12-month values of the economic indicator or indicators relate.

