Guidance Note AGN 113.5

Internal Ratings-based Approach to Credit Risk: Other Assets and Claims

Equity exposures\(^1,2\)

1. The measure of an equity exposure on which regulatory capital requirements are based is the current book value, including revaluations, net of any specific provisions.

2. A 300 per cent risk-weight applies to exposures that fall within the equity IRB asset class that are not deducted from capital\(^3\) and that are traded in the indices listed in Table 5 of Guidance Note AGN 116.3 The Standard Method.

3. A 400 per cent risk-weight applies to exposures that fall within the equity IRB asset class that are not deducted from capital and that are not traded in the indices listed in Table 5 of AGN 116.3.

4. Short positions held in the banking book are permitted to offset long positions in the same individual equities provided that these instruments have been explicitly designated as hedges of specific equity holdings and that they have remaining maturities of at least one year. Other short positions are to be treated as if they are long positions with the relevant risk-weight applied to the absolute value of each position. In the case of maturity mismatched positions, the methodology detailed in paragraphs 25 to 30 of Attachment A to Guidance Note AGN 112.4 Standardised Approach to Credit Risk: Comprehensive Approach to Credit Risk Mitigation must be applied.

Leases

5. Leases, other than those that expose an authorised deposit-taking institution (ADI) to residual value risk (refer paragraph 6 below), are treated as unsecured corporate exposures (refer Guidance Note AGN 113.2 Internal Ratings-based Approach to Credit Risk: Corporate, Sovereign and Bank Asset Classes).

---

\(^1\) The risk-weights are assumed to represent unexpected losses only.

\(^2\) Equities that are held in the trading book are treated in accordance with Prudential Standard APS 116 Capital Adequacy: Market Risk.

\(^3\) Refer to Prudential Standard APS 111 Capital Adequacy: Measurement of Capital.
6. Leases that expose the ADI to residual value risk\(^4\) will be treated in the following manner:

(a) the discounted lease payment stream will be risk-weighted according to the probability of default (PD) and loss given default (LGD)\(^5\) the ADI assigns to the lessee; and

(b) the residual value will be risk-weighted at 100 per cent.

**Fixed assets**

7. The risk-weight for investments in premises, plant and equipment and all other fixed assets is 100 per cent.

**All other exposures**

8. The risk-weight for all other exposures not otherwise defined in *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* or this Guidance Note, is 100 per cent.

---

\(^4\) Residual value risk is the risk that an ADI is exposed to potential loss due to the fair value of a leased asset declining below its residual estimate at the inception of the lease.

\(^5\) Use of supervisory or own-estimates of LGD will depend upon an ADI’s use of the foundation or advanced internal ratings-based (IRB) approach for its corporate exposures. In the case of the foundation IRB approach, a 45 per cent LGD estimate will be used.