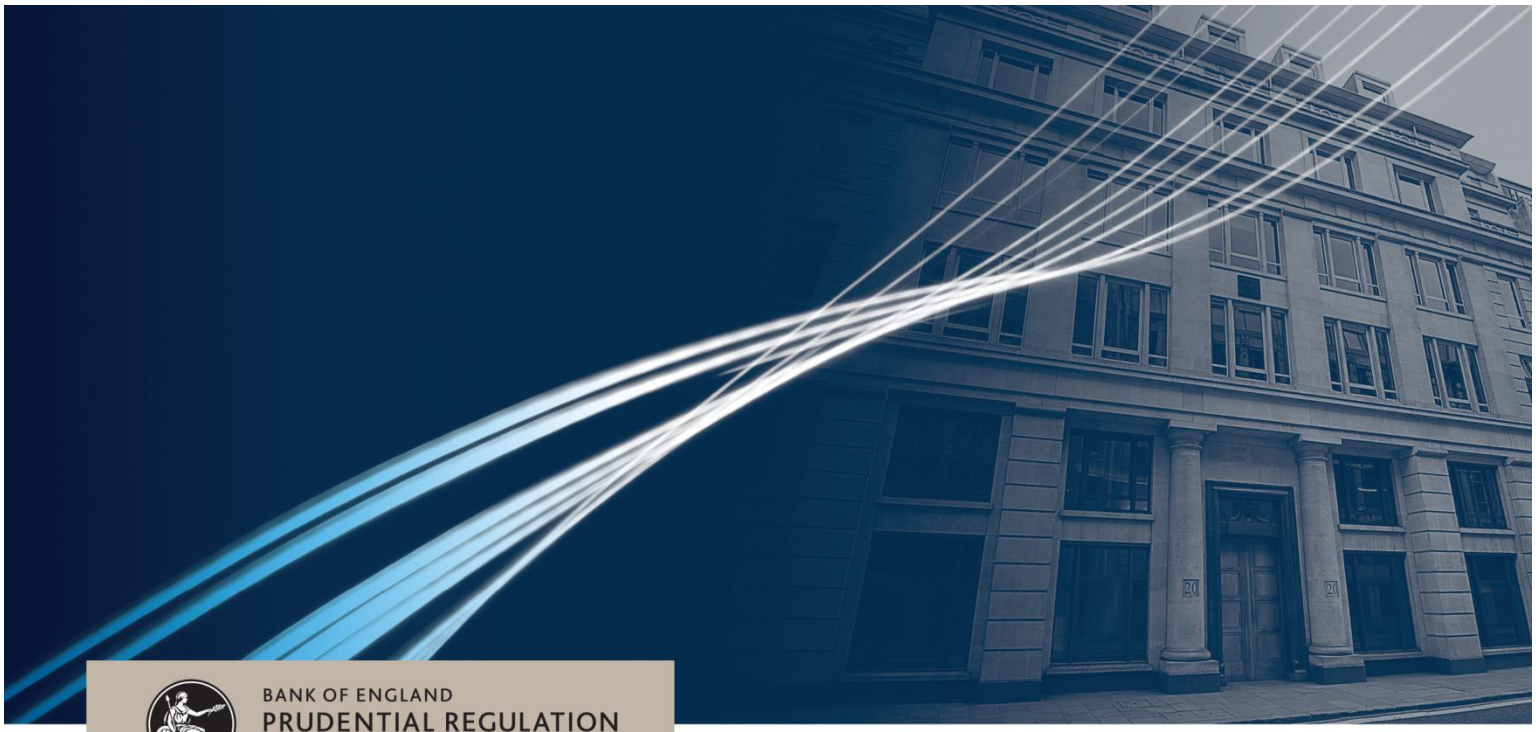

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper | CP12/18

Securitisation: The new EU framework and Significant Risk Transfer

May 2018

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper | CP12/18

Securitisation: The new EU framework and Significant Risk Transfer

May 2018

By responding to this consultation, you provide personal data to the Bank of England. This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the response itself.

The response will be assessed to inform our work as a regulator and central bank. We may use your details to contact you to clarify any aspects of your response.

Your personal data will be retained in accordance with the Bank's records management schedule. To find out more about how we deal with your personal data, your rights or to get in touch please visit bankofengland.co.uk/privacy.

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure to other parties in accordance with access to information regimes including under the Freedom of Information Act 2000 or data protection legislation, or as otherwise required by law or in discharge of the Bank's functions.

Please indicate if you regard all, or some of, the information you provide as confidential. If the Bank of England receives a request for disclosure of this information, we will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England.

Responses are requested by Wednesday 22 August 2018.

Please address any comments or enquiries to:
CP12-18
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

Email: CP12-18@bankofengland.co.uk

Contents

1 Overview

1.1 This consultation paper (CP) sets out the Prudential Regulation Authority's (PRA's) proposals on its approach to the European Union's Securitisation Regulation and certain aspects of the revised Capital Requirements Regulation (CRR) banking securitisation capital framework. This CP also proposes to update firms on the PRA's expectations with regard to Significant Risk Transfer (SRT) securitisation.

1.2 The proposals in this CP are relevant to all PRA-authorised Capital Requirements Directive IV (CRD IV) firms and all Solvency II firms.[1,2]

1.3 The new proposed PRA supervisory statement (SS) 'Securitisation: general requirements and capital framework', proposed amendments to SS9/13 which will be renamed 'Securitisation: Significant Risk Transfer',[3] and SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)',[4] can be found in Appendix 1, 2 and 3 respectively.

1.4 The PRA proposes to introduce the new SS 'Securitisation: general requirements and capital framework' in order to set out the PRA's approach and expectations in relation to:

(i) Chapter 2 (provisions applicable to all securitisations) of the incoming European Union Securitisation Regulation;[5]

(ii) firms that intend to sponsor Simple, Transparent and Standardised (STS) Asset Backed Commercial Paper (ABCP) programmes; and

(iii) the incoming securitisation capital framework introduced via Amendments to the CRR.[6]

1.5 SS9/13 'Securitisation', which currently covers only SRT securitisation, is proposed to be renamed 'Securitisation: Significant Risk Transfer'. The PRA proposes to amend this SS in order to clarify the role of firms' senior management, prudential treatment of excess spread and certain aspects of the PRA's assessment of commensurate risk transfer with respect to SRT securitisation.

1.6 The scope of application for the proposals in this CP varies depending on whether the proposals relate to the implementation of the Securitisation Regulation, revisions to the banking securitisation capital framework, or SRT securitisation. The CP is therefore split into two parts: Part 1 covering the new EU securitisation framework (relevant for all PRA-authorised CRD IV firms and all PRA-authorised Solvency II firms and potentially other firms pending HM Treasury discretions – see paragraph 2.4) and Part 2 covering SRT securitisation (relevant for PRA-authorised CRD IV firms only).

1 The Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR), jointly 'CRD IV'.
2 The Solvency II Directive (2009/138/EC) and the Solvency II Delegated Regulation (2015/35), jointly 'Solvency II'.
3 July 2017: www.bankofengland.co.uk/prudential-regulation/publication/2013/securitisation-ss.
4 April 2018: www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.
5 Regulation (EU) 2017/2402 of the European Parliament and Council of 12 December 2017, laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.
6 Regulation (EU) 2017/2401 of the European Parliament and Council of 12 December 2017, amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

Implementation

1.7 The date of application for the new securitisation legislative framework is Tuesday 1 January 2019.The proposals laid out in the proposed new PRA SS 'Securitisation: general requirements and capital framework' and SS31/15 would be effective from Tuesday 1 January 2019.

1.8 The proposals laid out which amend SS9/13 would apply immediately after the publication of a policy statement (PS) to all PRA-authorised CRD IV firms, as they are equally applicable to the current and Amended CRR.

Responses and next steps

1.9 This consultation closes on Wednesday 22 August 2018. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP12-18@bankofengland.co.uk.

1.10 The proposals in this CP have been designed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the European Union take effect.

PART 1: NEW EU SECURITISATION FRAMEWORK

2 Introduction to the new EU securitisation framework

Background

2.1 The new EU securitisation framework was published in the Official Journal of the European Union on Thursday 28 December 2017. It comes into application on Tuesday 1 January 2019. It includes:

(i) a 'Securitisation Regulation' which outlines general requirements for all securitisation activity in the European Union as well as the criteria and process for designating certain securitisations as STS; and

(ii) amendments to the CRR to implement revisions to the Basel securitisation capital framework.[1]

Securitisation Regulation

2.2 The new framework consolidates existing requirements (in sectoral legislation such as CRR and Solvency II) and strengthens the legislation on securitisation. Chapter 5 (Supervision) of the Securitisation Regulation requires prudential supervisors to supervise firms' compliance with Chapter 2 (hereafter called 'general requirements'). These include due diligence requirements for institutional investors (Article 5, hereafter called 'investor requirements') and requirements which apply to originators, sponsors, original lenders and Securitisation Special Purpose Entities (SSPEs) which are involved in the creation of a securitisation (Articles 6 to 9, hereafter called 'securitiser requirements'). These requirements are directly applicable to firms in scope.

2.3 The Securitisation Regulation requires national competent authorities to regularly review the arrangements, processes, and mechanisms that originators, sponsors, SSPEs, and original lenders have implemented in order to comply with the Securitisation Regulation. The PRA, Financial Conduct Authority (FCA) and The Pensions Regulator (TPR), as UK competent authorities, will be responsible for supervising compliance with the general requirements for firms which they prudentially supervise under European Union legislation referred to in Article 29 of the Securitisation Regulation.[2] A securitisation transaction may involve different entities which could be prudentially supervised by different UK competent authorities. The FCA, PRA and TPR will need to share information and co-operate in order to discharge their relevant functions under the Securitisation Regulation.

2.4 Member States have discretion to designate the competent authority (or authorities) responsible for supervising the compliance of:

(a) originators, original lenders and SSPEs not covered by the European Union legislation referred to in Article 29(3) of the Securitisation Regulation with the securitiser requirements; and

(b) originators, sponsors and SSPEs with Articles 18 to 27 (requirements relating to STS securitisation) of the Securitisation Regulation (hereafter called the 'STS requirements').

---

1 Basel III Document: Revisions to the securitisation framework www.bis.org/bcbs/publ/d374.htm.
2 For the PRA, this includes PRA-authorised CRD IV firms and PRA-authorised Solvency II firms (including Insurance Special Purpose Vehicles).

In the event that HM Treasury assigns any of these responsibilities to the PRA, a further clarification may be required to outline the PRA approach to those obligations. With respect to the securitiser requirements, the PRA is minded to adopt broadly the same approach to the firms in (a), should they be assigned to the PRA by HM Treasury, as to PRA-authorised CRD IV firms and all PRA-authorised Solvency II firms.

Amendments to the CRR

2.5 Amendments to CRR (Part Three, Title II, Chapter 5) implement revisions to the securitisation capital framework.[1] This includes new methods to calculate risk weights, and preferential treatment for STS securitisations meeting the criteria listed in the Amended CRR Article 243.

2.6 The revisions to the securitisation capital framework tackle shortcomings in the pre-crisis framework as observed during the financial crisis. The revisions seek to reduce mechanistic reliance on external ratings, increase risk weights for highly-rated securitisation exposures (which were seen as excessively low), reduce risk weights for low-rated senior securitisation exposures (which were seen as excessively high), reduce cliff effects, and enhance the risk sensitivity of the framework. This is achieved through comprehensive revisions to the methods for calculating risk-weighted capital requirements on exposures to securitisations. The introduction of a new hierarchy for determining the method to be used for calculating the Risk Weighted Exposure Amount (RWEA) of a securitisation position further promotes risk-sensitivity.

2.7 The hierarchy outlined in the CRR Amendment Regulation (Article 254, henceforth 'CRR hierarchy') differs from that in the Basel securitisation framework, in that firms are required to consider whether they can use the Securitisation Standardised Approach (SEC-SA) prior to the Securitisation External Ratings Based Approach (SEC-ERBA). However, the Amended CRR introduces a series of mechanisms that permit the ordering to revert to the Basel hierarchy, namely:

(i) automatic triggers tied to specified circumstances in which firms are required to use the SEC-ERBA instead of the SEC-SA (Article 254(2));

(ii) firm discretion to apply the SEC-ERBA instead of the SEC-SA to all rated exposures (Article 254(3)); and

(iii) competent authority discretion to prohibit, on a case by case basis, the use of the SEC-SA when the risk-weighted exposure amount resulting from the application of the SEC-SA is not commensurate with the risks posed to the institution or to financial stability (Article 254(4)).

2.8 In addition, Article 258(2) of the Amended CRR provides a competent authority with discretion to preclude the use of the Securitisation Internal Ratings Based Approach (SEC-IRBA) on a case by case basis, where securitisations have highly complex or risky features, consistent with the discretion in the Basel securitisation capital framework.[2]

2.9 Part Five of the CRR is deleted in the Amended CRR as these requirements duplicate the general requirements found in the Securitisation Regulation.

1 For the purpose of this CP, references to the CRR as amended are subsequently referred to as 'Amended CRR'.
2 Basel III Document: Revisions to the Securitisations framework, Standards text paragraph 15.

Amendments to the Solvency II capital framework

2.10 On Tuesday 17 April 2018 the Commission published draft amendments to Delegated Regulation (EU) 2015/35 ('draft amendments to the Solvency II Delegated Regulation') for consultation.[1] The draft amendments propose a new calibration for STS securitisations under the Solvency II capital framework.

2.11 The draft amendments to the Solvency II Delegated Regulation also propose to delete provisions in Delegated Regulation (EU) 2015/35 regarding due diligence and risk retention, as these requirements duplicate the general requirements found in the Securitisation Regulation.

Purpose

2.12 The proposals in this paper relating to the Securitisation Regulation aim to communicate the PRA's approach to supervising certain aspects of the new securitisation framework. This should promote clarity around the new framework and in turn support a well-functioning securitisation market. This improves safety and soundness as it promotes adequate due diligence around securitisation investments, and provides credit institutions with opportunities to diversify their funding base and manage their credit risk in a prudent manner.

2.13 The proposals relating to CRR amendments primarily clarify the PRA's proposed approach to exercising its discretions in relation to the methods used to calculate risk weights on their securitisation exposures. The exercise of these discretions will aim to ensure that firms appropriately capitalise the risks to which they are exposed. The proposals also include an updated mapping of External Credit Assessment Institutions (ECAI) ratings to the Credit Quality Steps (CQS) used in the SEC-ERBA, as an interim measure before an updated Implementing Technical Standard (ITS) is adopted.

3 Proposals relating to the EU securitisation framework

3.1 This Chapter is split into three sections:

(i) General requirements of the Securitisation Regulation, which is relevant to all PRA-authorised CRD IV firms and all PRA-authorised Solvency II firms involved in securitisation.

(ii) Sponsors of STS ABCP programmes, which is relevant to PRA-authorised credit institutions that intend to sponsor STS ABCP programmes.

(iii) Revisions to the CRR securitisation capital framework, which is relevant for PRA-authorised CRD IV firms.

General requirements of the Securitisation Regulation

3.2 This section is relevant for all PRA-authorised CRD IV firms and all PRA-authorised Solvency II firms involved in securitisation. In the event that HM Treasury assigns responsibilities under Securitisation Regulation 29(4) to the PRA for supervising the compliance of firms not authorised under CRD IV or Solvency II with the securitiser requirements, the PRA is currently minded to adopt broadly the same approach to such firms.

1 Revised calibrations for securitisation investments by insurance and reinsurance undertakings under Solvency II: ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-2037113_en.

Securitiser requirements

Arrangements, processes and mechanisms to comply with the Securitisation Regulation

3.3 The PRA proposes that firms which act as originators, original lenders and sponsors should be prepared to demonstrate to the PRA, on request, that they have in place adequate arrangements, processes and mechanisms in order to comply with the securitiser requirements of the Securitisation Regulation. The PRA also proposes that firms' internal audit functions and relevant individuals performing Senior Management Functions (SMF) have sufficient oversight over such arrangements, processes and mechanisms.

3.4 In assessing firms' compliance with relevant requirements, the PRA proposes to pay particular attention to those firms which, as observed through regulatory returns and other supervisory reporting, are active in securitisation markets or whose securitisation activity changes over time.

Insurance firms, reinsurance firms or insurance special purpose vehicles (ISPVs) as originators

3.5 The SS 'Securitisation: general requirements and capital framework' in Appendix 1 clarifies that it is possible for insurance or reinsurance firms, as well as insurance special purpose vehicles (ISPVs), to be originators within the meaning of Article 2(3) of the Securitisation Regulation. As the Securitisation Regulation defines securitisation by reference to the substance of the transaction, and not with reference to the involvement of third-party investors, it is possible for intra-group transactions and internal restructurings (eg to create matching adjustment (MA) eligible cashflows) to be considered securitisations provided they otherwise meet the definition in Article 2(1) of the Securitisation Regulation.

3.6 The PRA proposes that insurance firms, reinsurance firms and ISPVs should consider whether any restructuring of loans, exposures or receivables into tranched securities may be considered securitisations. Where insurance firms, reinsurance firms or ISPVs identify themselves as the originator of a securitisation, they should inform their supervisor without undue delay. This should ensure that the PRA is able to discharge its supervisory obligations in respect of securitisers under the Securitisation Regulation.

3.7 The European Securities and Markets Authority (ESMA), in close co-operation with the European Banking Authority (EBA) and European Insurance and Occupational Pensions Authority (EIOPA), is required to develop draft Regulatory Technical Standards (RTS) and ITS on the information which the originator, sponsor and SSPE are required to provide to comply with their obligations under points (a) and (e) of Article 7(1), including the development of standardised templates, taking into account the usefulness of the information for the holder of a securitisation position. ESMA consulted on draft RTS on Tuesday 19 December 2017, but at the date of publication of this CP, the RTS is still in draft form.[1] The ESMA consultation document proposes that private securitisations will be exempt from the requirement to use the standardised templates in the RTS and ITS. Whether this is in fact the case will depend on the RTS and ITS that may ultimately be adopted by the European Commission.

3.8 In the PRA's view, the requirements set out in Article 7(1) of the Securitisation Regulation are not intended or designed to apply in the case where the originator is also the sole investor in the transaction. Therefore, the PRA does not anticipate that the RTS or ITS will address such

1 Consultation Paper on Draft technical standards on disclosure requirements, operational standards, and access conditions under the Securitisation Regulation: www.esma.europa.eu/press-news/consultations/consultation-disclosure-and-operational-standards.

situations. Accordingly, the PRA proposes to clarify at this stage its expectations of how the disclosure requirements would apply in those situations. The PRA may make amendments to this section of the SS in the event that the final ESMA RTS does clarify how disclosure requirements would apply in the case where the originator is also the sole investor in the transaction.

Investor requirements

3.9 The PRA proposes that firms should be able to evidence that they perform due diligence as required under Article 5. Where firms have delegated the authority to manage their investments to another institutional investor, the PRA proposes that firms should instead be able to evidence that they have instructed the managing party to fulfil the due diligence requirements.

3.10 In assessing firms' compliance with the due diligence requirements, the PRA proposes it would pay particular attention to firms that, as observed through regulatory returns and other supervisory reporting, actively invest in securitisation or whose securitisation investment is changing over time.

Sponsors of Simple, Transparent and Standardised (STS) Asset Backed Commercial Paper (ABCP) programmes

3.11 This section is only relevant for PRA-authorised CRD IV firms.

3.12 Credit institutions supervised by the PRA under CRD IV may act as sponsors for an STS ABCP programme using one of the following routes:

(i) the credit institution demonstrates to its competent authority that the support it provides to the programme would not endanger its solvency and liquidity, even in an extreme market stress (Article 25(3), subparagraph 1); or

(ii) the competent authority has determined on the basis of the review and evaluation referred to in Article 97(3) of CRD IV that the arrangements, processes, and mechanisms implemented by that credit institution, and the own funds and liquidity it holds, ensure the sound management and coverage of its risks (Article 25(3), subparagraph 2).

3.13 The PRA considers that as regards PRA-authorised CRD IV firms it is the 'competent authority' for the purposes of Article 25(3). Other aspects of the STS framework in the UK will be supervised by the competent authority or competent authorities designated by HM Treasury under Securitisation Regulation Article 29(5).

Article 25(3) subparagraph 1

3.14 The PRA proposes that should a firm wish to become a sponsor of an STS ABCP programme under Article 25(3) subparagraph 1, it should contact its supervisor with sufficient information, as specified in the proposed SS 'Securitisation: general requirements and capital framework' (see Appendix 1).

3.15 The PRA proposes that it should be granted sufficient time to assess this information. In particular, where firms wish to set up new conduits, or are proposing to sponsor an ABCP programme for the first time, they should submit relevant information well in advance of executing the transaction.

Article 25(3) subparagraph 2

3.16 Where a firm wishes to become a sponsor of an STS ABCP programme under Article 25(3) subparagraph 2, the PRA proposes that it should make a request to its supervisor prior to the submission of either its ICAAP or Internal Liquidity Adequacy Assessment Process (ILAAP) documents. A request to use the route under Article 25(3) should also be accompanied by the minimum information as specified in the proposed SS 'Securitisation: general requirements and capital framework', where that information is not already included in the ICAAP and ILAAP documents (Appendix 1).

3.17 The PRA proposes that a firm should avoid using the route specified in Article 25(3) subparagraph 2 unless it currently sponsors at least one ABCP programme. Prior to becoming a sponsor, the ICAAP and ILAAP documents of a firm will provide limited insight into the firm's management and coverage of the liquidity and other risks it will face as a sponsor. Therefore where a firm does not already sponsor an ABCP programme, the PRA does not regard it possible to determine, based on its SREP covering capital and liquidity (SREP and Liquidity Supervisory Review and Evaluation Process (L-SREP)), that it is able to manage appropriately its risks, including those associated with sponsoring an ABCP programme.

3.18 The PRA proposes that following the completion of the next SREP and L-SREP after the request from the firm has been made, the PRA will notify the firm as to whether it has determined, on the basis of its review, that the arrangements, strategies, processes and mechanisms implemented ensure sound management and coverage of risk.

The CRR securitisation capital framework

3.19 This section is only relevant for PRA-authorised CRD IV firms.

3.20 Under the Amended CRR, securitisations in which the securities were issued before Tuesday 1 January 2019 may continue to apply the current CRR securitisation capital framework until Tuesday 31 December 2019. The proposals in this chapter only apply to positions subject to the new CRR securitisation capital framework.

3.21 The amendments to CRR revise the securitisation capital framework. Article 254 of the Amended CRR requires firms to use the CRR hierarchy to calculate RWEAs for a securitisation position where the:

- conditions set out in Article 258 are met, the Securitisation Internal Ratings Based Approach (SEC-IRBA) in accordance with Articles 259-260;

- SEC-IRBA may not be used, the Securitisation Standardised Approach (SEC-SA) in accordance with Article 261-262; and

- SEC-SA may not be used, the SEC-ERBA in accordance with Articles 263-264 for rated positions or positions in respect of which an inferred rating may be used.

3.22 Article 254(2) requires firms to use SEC-ERBA instead of SEC-SA for certain securitisation positions. Article 254(3) allows a firm to use SEC-ERBA instead of SEC-SA for all of its rated securitisation positions or positions in respect of which an inferred rating may be used.

3.23 The section sets out the PRA's proposals relating to:

- competent authority discretions under Articles 254(4) and 258(2) to prohibit the use of the SEC-SA or SEC-IRBA respectively on a case by case basis; and

- the mapping of ECAIs credit ratings to CQS for the SEC-ERBA.

PRA discretions on the hierarchy of methods

3.24 The PRA proposes to use its discretions on the hierarchy of methods in order to support its broader objectives of promoting the safety and soundness of firms. A risk to safety and soundness may arise where risk weights arrived at under the SEC-SA or SEC-IRBA result in Pillar 1 capital requirements which do not reflect the risk posed to the firm. Where appropriate, the PRA will monitor Pillar 1 requirements arising from securitisation using the information in a firm's ICAAP document, supplemented with other sources such as regulatory reporting. The PRA may, if it deems it necessary, request further information from firms to further assess whether a risk to safety and soundness exists. Where the PRA identifies a risk, and determines that the use of its discretions will mitigate that risk, it will notify the decision to a firm in writing.

3.25 The PRA proposes to pay particular attention to certain securitisation features when deciding whether to exercise its discretion to prohibit the use of a method it does not consider appropriate for calculating the risk weight of a securitisation position. The formula-based methods (the SEC-SA and SEC-IRBA) may not explicitly capture features of securitisations which may expose holders to additional risks within the securitisation. These may include non-credit risks or underlying exposures for which the standardised or Internal Ratings Based (IRB) approach to estimating the credit risk in some cases may be inappropriate. Where these additional risks are captured by ECAIs in their credit assessment, the SEC-ERBA approach may provide a more appropriate estimation of risk. Furthermore where securitisation positions are unrated, and where no rating may be inferred, the PRA proposes that a 1,250% risk weight could in some cases be more appropriate than risk weights under the SEC-SA or SEC-IRBA.

3.26 The PRA proposes to amend SS31/15 to clarify how firms should assess the appropriateness of different methods in measuring securitisation risk, and also to specify minimum information which should be included in a firm's ICAAP document (see Appendix 3). The PRA already requires firms as part of their ICAAP to assess whether they have, on an ongoing basis, the amounts, types, and distribution of financial resources, own funds, and internal capital that it considers adequate to cover its risks, including securitisation risk.[1]

3.27 The PRA proposes that firm's assessment of securitisation risks (or credit risk arising from securitisation exposures) should include the following:

(i) the risk characteristics and structural features of a securitisation, including those of underlying exposures, which can materially impact the performance of any held positions in that securitisation;

(ii) whether there are material differences in risk weights for a position under the SEC-IRBA, SEC-ERBA and the SEC-SA (insofar as each method can be used); and

(iii) the extent to which differences identified in (ii) may be caused by the considerations in (i) as well as the approach taken by an ECAI in rating a particular asset class.

3.28 The PRA proposes that a firm's record of its approach to evaluating and managing securitisation risk should be prepared under Internal Capital Adequacy Assessment 13.1 of the

1 Internal Capital Adequacy Assessment 3.1 of the PRA Rulebook: www.prarulebook.co.uk/rulebook/Content/Part/211179/10-04-2018.

PRA Rulebook.[1] This should adequately summarise this analysis, supplemented with a breakdown on the usage of different methods under the CRR hierarchy and the extent to which the firm is exposed to unrated securitisation positions for which a rating cannot be inferred. The information provided in ICAAP documents as proposed in this CP should assist the firm and its supervisor to form a view of whether capital requirements are commensurate to risks, and whether securitisations to which the firm is exposed exhibit complex or highly risky features.

3.29 The PRA proposes that it may request additional information from firms. The PRA expects that such additional information will already be available to firms as a result of work undertaken to comply with the requirements of the Securitisation Regulation, in particular the obligation to carry out due diligence. Firms will be expected to provide this additional information, upon request by the PRA, within 20 business days.

3.30 The PRA's proposed approach to assessing whether risk weights under the SEC-SA are commensurate with risks posed to the firm, and whether positions to which the SEC-IRBA is applied have 'highly complex or risky' features is outlined in the new proposed SS 'Securitisation: general requirements and capital framework' (see Appendix 1). The PRA, in conjunction with the Financial Policy Committee (FPC), or on its own initiative, may identify financial stability risks arising from firms' securitisation activity. It may be that this risk could be mitigated by use of PRA's discretion to prohibit the use of the SEC-SA where the RWEA calculated under that approach is not commensurate with the risks posed to financial stability.

3.31 A PRA decision to prohibit the use of SEC-SA or SEC-IRBA may be made with respect to individual securitisation positions, or a group of securitisation positions.

3.32 For rated securitisation positions or positions where a rating can be inferred, where the PRA prohibits the use of the SEC-IRBA or the SEC-IRBA cannot be used, and the PRA has prohibited the use of SEC-SA, that exposure must be risk-weighted under the SEC-ERBA. For unrated positions where no rating can be inferred, that exposure will be risk-weighted at 1,250% in accordance with Article 254(7).

3.33 The PRA will keep its approach to its use of the discretions in CRR Articles 254(4) and 258(2) under review. In particular, the PRA may choose to revise its approach following developments in the securitisation market or in response to changes to the underlying standardised or IRB approaches to credit risk.

Mapping of ECAI Structured Finance Credit Assessments to CQS under SEC-ERBA

3.34 In order to determine risk weights under the SEC-ERBA, firms must use a mapping table to determine the appropriate CQS step for the ECAI rating which has been assigned to a securitisation position. The EBA has produced mapping tables for the current CRR Ratings Based Approach (RBA), however an update to the tables is needed as the SEC-ERBA increases the number of CQS which can be used for long-term ratings. Amended CRR Article 270e requires the EBA to produce ITS on mapping of the credit assessments of ECAIs for securitisations to CQS specified in the CRR.

3.35 The PRA proposes to provide an interim mapping (see Table 1, Appendix 1) which would be superseded by the updated ITS once it is adopted.

1 Internal Capital Adequacy Assessment 13.1 of the PRA Rulebook: www.prarulebook.co.uk/rulebook/Content/Part/211179/10-04-2018.

3.36 As additional CQS have only been introduced for the long-term credit assessments, the PRA proposes a mapping of CQS to the illustrative Basel long-term rating designations.[1] For short-term credit assessments, where no additional CQS are introduced, the PRA proposes that firms use the short-term rating mapping found in Annex II of Regulation (EU) 2016/1801 during the interim period until a revised ITS or equivalent instrument is formally adopted.[2]

3.37 The PRA proposes to insert a paragraph into SS9/13 in order to clarify that as part of reviewing an SRT transaction the PRA may assess the expertise of a chosen credit rating agency in the asset class used as collateral for the securitisation positions being rated. For SRT securitisation, EBA Guidelines require competent authorities to consider whether the chosen credit rating agency has appropriate experience and expertise in the asset class being rated.[3] The PRA also expects firms to continue to ensure that, for an ECAI rating to be used under the SEC-ERBA, ratings meet all of the conditions in Article 270c of the Amended CRR.

The Solvency II securitisation capital framework

3.38 The PRA does not make any proposals regarding the Solvency II securitisation capital framework in this CP. The PRA may decide that additional clarification is needed once the proposed amendments to Delegated Regulation (EU) 2015/35 are agreed and adopted into the Official Journal of the European Union.

1 Basel, July 2016, 'Revisions to the Securitisation Framework'. The Basel rating designations referenced are for illustrative purposes only and do not indicate any preference for, or endorsement of, any particular external assessment system.
2 Commission Implementing Regulation (EU) 2016/1801 on laying down technical standards with regard to the mapping of credit assessments for securitisation.
3 EB guidelines 2014/05, Title II, page 16. '9. Credit Ratings': www.eba.europa.eu/documents/10180/749215/EBA-GL-2014-05+Guidelines+on+Significant+Risk+Transfer.pdf.

PART 2: SIGNIFICANT RISK TRANSFER

4 Significant Risk Transfer Securitisation

Background

4.1 This part of the CP is only relevant for PRA-authorised CRD IV firms transferring significant credit risk through SRT securitisation. The PRA will update references to the CRR in SS9/13 on Tuesday 1 January 2019 so that any references are to the Amended CRR.[1]

4.2 The CRR requires any reduction in capital requirements achieved through securitisation via SRT be justified by a commensurate transfer of risk to third parties. Three options are provided for firms within the CRR to demonstrate how they transfer significant credit risk for any given securitisation transaction. These are outlined in the existing SS9/13 (paragraphs 3.2-3.5).

4.3 Firms must notify the PRA of securitisation which results in a reduction in capital requirements via SRT, in line with Credit Risk 3.1 of the PRA Rulebook. In these cases, the PRA reviews the information submitted, in line with SS9/13, to assess whether the possible reduction in RWEA is justified by a commensurate transfer of risk.

4.4 Where the PRA considers that the possible reduction in RWEA achieved via the securitisation is not justified by a commensurate transfer of risk to third parties, then the PRA will find SRT has not been achieved. Consequently, firms will not be able to recognise any reduction in RWEA from the transaction.

Relevance of recent and forthcoming regulatory developments in SRT securitisation

4.5 The changes proposed in this section of the CP provide an update on the PRA's expectations of firms which seek to obtain SRT under the current and incoming securitisation capital framework.

4.6 The EBA has published a Discussion Paper (DP) on SRT securitisation which closed for comments on Tuesday 19 December 2017.[2] In accordance with CRR Articles 244(6) and 245(6), the EBA shall report its findings to the European Commission by Saturday 2 January 2021. Following this, the European Commission may choose to adopt a Delegated Regulation to further specify certain aspects of the CRR SRT framework. In the event that a Delegated Regulation is adopted, the PRA will review SS9/13. Generally, the PRA will keep its approach as set out in SS9/13 under review.

4.7 This CP does not consider all the areas of discussion, or the features addressed, within the EBA DP. The PRA will continue to develop its approach to other structural features which may impact the risk transferred to third parties in SRT securitisation.

Purpose

4.8 The PRA considers that the proposals in this part of the CP serve the following purposes:

(i) Provide clarity on the PRA's expectations for firms undertaking SRT securitisations that incorporate excess spread features or use standardised approach (SA) portfolios.

---

1 PRA SS9/13 'Securitisation', December 2013: www.bankofengland.co.uk/prudential-regulation/publication/2013/securitisation-ss.

2 EBA DP September 2017 'Discussion Paper On The Significant Risk Transfer in Securitisation': www.eba.europa.eu/regulation-and-policy/securitisation-and-covered-bonds/discussion-paper-on-the-significant-risk-transfer-in-securitisationsecuritisation.

(ii) Clarify the accountability of senior management in relation to these transactions.

5 Proposals relating to Significant Risk Transfer

5.1 The policy proposals in this chapter would be implemented as updates to SS9/13.

SRT in the presence of excess spread

5.2 The CRR defines excess spread as 'finance charge collections and other fee income received in respect of the securitised exposures net of costs and expenses'. The PRA recognises that excess spread can be formulated in a range of different ways, and expects firms to take a 'substance over form' approach to the treatment of excess spread features in SRT securitisations. The PRA considers that the presence of a synthetic excess spread (SES) feature in a junior position within a synthetic securitisation capital structure impacts on the transfer of risk to third parties, by providing credit enhancement to more senior tranches. The PRA considers SES to be a complex feature, and the presence of such features makes it more difficult to demonstrate a commensurate transfer of risk.

5.3 The impact of SES on risk transfer acts in a manner similar to other recognised forms of credit enhancement, such as a retained first loss tranche. The PRA intends to avoid any potential market distortion arising from a different prudential treatment of structural features that can be considered to provide protection in a similar manner.

5.4 Firms which intend to include features such as SES in an SRT transaction should be able to demonstrate an adequate quantification of the risk retained, and reflect this retained risk in their post-transaction capital requirements. For the purposes of calculating capital requirements, the PRA considers it appropriate to treat SES as an off-balance sheet securitisation position.

5.5 Firms should measure the nominal value of the off-balance sheet securitisation position as a reasoned and prudent estimate of the credit enhancement provided by the SES feature, for example as compared to a retained first loss tranche. Firms shall apply a 1,250% risk weight to this nominal value, or alternatively deduct from Common Equity Tier 1 items in accordance with point (k) of Article 36(1). The PRA does not propose to make a distinction between portfolios with different underlying asset classes.

5.6 The presence of excess spread in traditional securitisations (TES) may, in certain transactions, impact the transfer of credit risk to third parties, where it is used to absorb losses, providing credit enhancement to more senior tranches. In certain transactions, for example, a contractual agreement foresees that excess spread not eroded by losses is extracted from the transaction to the benefit of the originator, as deferred consideration. This is the case where, for instance, the securitised exposures are sold at par value despite their fair value being higher than par. In these circumstances, the PRA expects firms to treat the credit enhancement provided by TES in a similar manner to the approach described for SES, by measuring the credit enhancement provided and applying a 1,250% risk weight or deduction from capital.

5.7 The PRA will keep its approach to excess spread under review.

Assessing CRT for securitisations of SA portfolios

5.8 The PRA proposes to clarify its general expectations regarding tranche thickness and commensurate risk transfer (CRT) by updating Chapter 2 'High Level SRT considerations' within

the existing SS9/13. For the assessment of CRT for all SRT securitisations, the PRA expects firms to ensure that the tranches sold, or on which protection is purchased, are sufficiently thick such that the reduction in capital requirements can be justified by a commensurate transfer of risk to third parties.

5.9 The PRA expects firms to consider all relevant factors in their analysis supporting the thickness of tranches for SRT transactions. The PRA recognises that such analysis may be more difficult for securitisation of SA portfolios, as there may be less high-quality data available. The PRA also recognises that SA risk weights may be more or less conservative than IRB risk weights for otherwise equivalent portfolios.[1] It is possible that for some portfolios, SA risk weights may underestimate the risk on the underlying exposures, in turn overstating the risk transferred to third parties. This could lead to firms underestimating the risk they are exposed to on retained tranches of securitisations of SA exposures.

5.10 When justifying risk transfer for the securitisation of SA portfolios, the PRA proposes that firms should consider the thickness of tranches sold, or on which protection has been purchased, in a prudent manner. To provide confidence that commensurate risk has been transferred, the PRA expects firms to compare the detachment point (D) of sold, or protected tranches against the K_{SA} of the portfolio.[2] The PRA proposes to apply a scalar of 1.5 to K_{SA} to determine the minimum value of D for these purposes, unless firms can evidence that a lower uplift factor is appropriate. The PRA will remain flexible in assessing firms' evidence for a reduced scalar to K_{SA}, and will consider the use of external data sources where it is comparable and representative.

5.11 For the avoidance of doubt, the PRA is not proposing an increase to capital requirements, rather clarifying that when justifying CRT for SRT securitisations, the protected or sold tranches should have a prudent detachment point.

5.12 The PRA will keep its approach to the assessment of CRT for SRT securitisations of SA portfolios under review.

Senior management engagement in SRT securitisation

5.13 The PRA proposes to amend two clauses in SS9/13 (paragraphs 2.7 and 3.8), in order to clarify the PRA's expectations for senior management engagement in SRT securitisation. In particular, the PRA proposes to align the governance expectations for SRT transactions to the Senior Managers Regime (SMR).

5.14 Furthermore, the PRA proposes to explicitly reference Fundamental Rule 7 in the expectations set out in SS9/13 in relation to the information firms should submit, when notifying the PRA of SRT securitisations.

5.15 The PRA has observed a variety of interpretations of the governance expectations set out in SS9/13. The proposals above seek to clarify the expectations set out in SS9/13 and ensure accountability for senior management engaged in these transactions, both in the preparation of information submitted to the PRA and in any further communication, on an ongoing basis.

1 PS22/17 'Refining the PRA's Pillar 2A capital framework, October 2017: www.bankofengland.co.uk/prudential-regulation/publication/2017/refining-the-pra-pillar-2a-capital-framework.

2 K_{SA}: RWEA in respect of the underlying exposures as if they had not been securitised multiplied by 8% and divided by the value of the underlying exposures.

5.16 In balancing the need for accountability with proportionality, the PRA proposes that the level of engagement vary in line with the complexity or amount of reduction in RWEA which would be achieved by the securitisation.

6 The PRA's statutory obligations

6.1 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to consult when setting its general policies and practices.[1] In doing so, it is required to comply with several statutory and public law obligations. The PRA meets these obligations by providing the following in its consultations:

(i) a cost benefit analysis;

(ii) an explanation of the PRA's reasons for believing that making the proposed policy is compatible with the PRA's duty to act in a way that advances its general objective,[2] insurance objective[3] (if applicable), and secondary competition objective;[4]

(iii) an explanation of the PRA's reasons for believing that making the proposed policy is compatible with its duty to have regard to the regulatory principles;[5] and

(iv) a statement as to whether the impact of the proposed policy will be significantly different to mutuals than to other persons.[6]

6.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.[7]

6.3 The PRA is also required by the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.[8]

Cost benefit analysis

6.4 The requirements of the Securitisation Regulation directly apply to PRA-authorised firms as of Tuesday 1 January 2019. The PRA is of the view that its proposals as regards the implementation of the Securitisation Regulation do not materially add to the existing cost of these requirements. Proposals in this CP relating to the Securitisation Regulation clarify the PRA's approach to supervising firms' compliance with parts of the framework and assessing suitability of STS ABCP sponsors. The PRA will, where possible, use the information available from other sources such as regulatory reporting and securitisation repositories to supervise firms. It does not propose any additional regular reporting. For firms wishing to sponsor an STS ABCP programme, the proposals specify the information needed by the PRA.

6.5 The proposals regarding the PRA's discretions on the hierarchy of methods support the safety and soundness of firms, while utilising the existing ICAAP process and thus reducing burden on firms relative to other options such as regular additional reporting. The PRA may

1 Section 2L of FSMA.
2 Section 2B of FSMA.
3 Section 2C of FSMA.
4 Section 2H(1) of FSMA.
5 Section 2H(2) and 3B of FSMA.
6 Section 138K of FSMA.
7 Section 30B of the Bank of England Act 1998.
8 Section 149.

ask for additional information which should normally have been collected by firms in order to comply with the Securitisation Regulation due diligence requirements (Article 5). The clarification on the PRA's approach to exercising the hierarchy discretions and the proposed mapping of ECAI credit assessments to CQS steps should reduce uncertainty in assessing securitisation capital requirements and thus supporting their securitisation activity.

6.6 The PRA considers that the proposed treatment of excess spread balances the use of this feature against potential market distortion that would arise if excess spread were treated any differently to an equivalent first loss tranche. The proposed approach to assessing commensurate risk transfer on SA portfolios allows firms to use SRT securitisation to transfer risks on these portfolios in a prudent manner. The proposals relating to the role of senior management reduce overlap of requirements by aligning this role with the already applicable SMR.

Compatibility with the PRA's objectives

6.7 The proposals in this CP intend to ensure that firms' engagement in securitisation activity maintains the standards of the new securitisation framework. These standards address several shortcomings observed during the financial crisis through promoting greater transparency, alignment of investor and issuer interests, and due diligence. Firms' compliance with the new securitisation framework thus contributes to their safety and soundness while offering them an opportunity to diversify their funding base or reduce capital requirements by transferring credit risk to third parties.

6.8 Proposals relating to the Amended CRR and hierarchy of methods also aim to promote an adequate capitalisation of the securitisation risks which PRA-regulated CRD IV firms are exposed to on both an individual and consolidated basis.

6.9 The proposals in this CP relating to SRT securitisation intend to reduce the risk of undercapitalisation of firms and increase certainty that any reduction in RWEA is commensurate to the risk transferred to third parties, a necessary condition for SRT as specified in CRR Article 243 and Article 244. These measures contribute to the safety and soundness of firms. The proposal to align the expectations on senior management engagement in the execution of SRT securitisation also contributes to the safety and soundness of firms by strengthening accountability of senior management in relation to SRT transactions.

6.10 The PRA has assessed whether the proposals in this CP facilitate effective competition. By consolidating and applying minimum standards for securitisation consistently across the European Union, the Securitisation Regulation promotes effective competition by making it easier for firms to engage in securitisation issuance and investment activity. The proposals in this CP relating to implementation support the compliance of PRA-authorised firms with the Securitisation Regulation.

6.11 The PRA recognises that it may be more difficult to justify CRT for SRT securitisations of SA portfolios as there may be less high-quality data available. Consistent with its secondary objective to so far as is reasonably possible act in a way that facilitates effective competition, the PRA proposes to apply a scalar to K_{SA} as part of its assessment of CRT for SRT securitisation of SA portfolios. This will increase confidence of firms when considering the detachment point while structuring a securitisation and subsequently seeking to demonstrate CRT for SRT securitisations of SA portfolios. The PRA will remain flexible in assessing firms' evidence for a reduced scalar to K_{SA}, and will consider the use of external data sources where comparable and representative.

Regulatory principles

6.12 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Four of the principles are of particular relevance.

6.13 The principle that the PRA will use its resources in the most efficient and economic way. For the proposals regarding the hierarchy of methods, the PRA has followed this principle when developing the proposals outlined in this CP, by adopting a model where firms are asked to provide the conclusions of their own assessment in the ICAAP document instead of creating additional data requests on firms to be analysed by the PRA. Furthermore, by clarifying the PRA's expectations on excess spread and SA portfolios, firms can be more confident that transactions may meet the PRA's expectations before providing an SRT notification. This ensures appropriate use of supervisory resource by the PRA in reviewing SRT transactions. By clarifying the PRA's expectations of senior management engagement in the execution of SRT securitisation, the PRA seeks to ensure transactions have been through appropriate internal governance before firms notify the PRA.

6.14 The principle that a burden or restriction should be proportionate to the benefits. The PRA has followed this principle and for proposals relating to the new EU securitisation framework, does not propose any specific additional reporting templates in this CP. It instead proposes to rely primarily on existing sources of information such as the ICAAP document, regulatory reporting and other information received from regulated firms. By providing examples of additional information which the PRA may request, the PRA also reduces uncertainty for firms.

6.15 The principle of senior management's responsibility in relation to compliance. The PRA has followed this principle in clarifying the involvement of relevant individuals performing Senior Management Functions in relation to general issuance, and to clarify the PRA's expectations of appropriate senior management engagement in the execution of transactions which lead to reduction in RWEA.

6.16 The principle of the PRA is to exercise transparency. The PRA has followed this principle by clarifying its approach to the use of supervisory discretions granted under the new CRR securitisation capital framework. This should allow firms to understand and anticipate supervisory action regarding their exposures to securitisation.

Impact on mutuals

6.17 In the PRA's opinion, the impact of the proposed rule changes on mutuals is expected to be no different from the impact on other firms.

HM Treasury recommendation letter

6.18 HM Treasury has made recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[1]

6.19 The aspects of the Government's economic policy most relevant to the proposals in this CP are:

(i) Competition;

1 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at: www.bankofengland.co.uk/about/Pages/people/prapeople.aspx.

(ii) Growth;

(iii) Competitiveness;

(iv) Trade; and

(v) Better outcome for consumers.

6.20 Aspects (i) to (ii) and (iv) to (v) have been considered in the 'compatibility with the PRA's objectives' and 'regulatory principles' sections above. Aspect (iii) is considered further below.

Competitiveness

6.21 The PRA is of the view that the proposals presented in this CP would not reduce the competitiveness of PRA-authorised firms. The most relevant proposal in this regard is that relating to the PRA usage of its discretions regarding the hierarchy of methods. The PRA expects to exercise the discretions to prohibit the use of the SEC-SA or SEC-IRBA under specific circumstances, in order to mitigate risk to the safety and soundness of PRA-authorised firms.

Equality and diversity

6.22 The PRA does not consider that the proposals give rise to equality and diversity implications.

Appendices

1	**Draft supervisory statement 'Securitisation: general requirements and capital framework'**
2	**Draft amendments to Supervisory Statement 9/13: Securitisation: Significant Risk Transfer**
3	**Draft amendments to Supervisory Statement 31/15: The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)**

Appendix 1: Draft supervisory statement 'Securitisation: general requirements and capital framework'

1 Introduction

1.1 This statement is relevant to PRA-authorised CRD IV firms and PRA-Authorised Solvency II firms to which the Securitisation Regulation applies unless stated otherwise.[1] This includes PRA-authorised UK banks, building societies, PRA-designated UK investment firms, UK insurance firms and UK insurance special purpose vehicles (ISPVs).

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations of firms in respect of securitisation in the following chapters:

(1) 'General requirements under the Securitisation Regulation' – general expectations of firms and processes under Chapter 2 of the Securitisation Regulation.

(2) 'STS ABCP Sponsors'- general expectations of firms seeking to become sponsors of Simple Transparent and Standardised (STS) Asset Backed Commercial Paper (ABCP) programmes.

(3) 'CRR securitisation capital framework' - PRA expectations and approach as regards the securitisation capital framework for firms to which Directive 2013/36/EU (CRD IV) applies.

2 General requirements under the Securitisation Regulation

2.1 This part of the statement is relevant to PRA-authorised CRD IV firms and PRA-Authorised Solvency II firms to which the Securitisation Regulation applies.

Originator, original lender and sponsor requirements

General requirements

2.2 The PRA expects firms which act as originators, original lenders and sponsors in a securitisation who are subject to the requirements of the Securitisation Regulation to be able to demonstrate to the PRA, on request, that they have in place adequate arrangements, processes and mechanisms in order to comply with Articles 6, 7, 8 and 9 of the Securitisation Regulation.

2.3 A firm should inform its supervisor if it anticipates material change in its securitisation activity as an originator or sponsor, such as engaging in securitisation issuance for the first time, including securitising an asset class for the first time or significantly increasing the amount of issuance.

Governance arrangements, processes and mechanisms

2.4 Where a firm acts as an originator, original lender or sponsor in a transaction subject to the requirements of the Securitisation Regulation, the PRA expects the firm's internal audit function to provide assurance that the firm's involvement in the securitisation is compliant with the requirements in Articles 6, 7, 8 and 9 of the Securitisation Regulation.

1 Regulation (EU) 2017/2402 of the European Parliament and Council of 12 December 2017, laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

2.5 The PRA expects that relevant individuals performing Senior Management Functions (SMFs), such as the individual to whom Prescribed Responsibility (PR) 7 has been allocated, exercise effective oversight of securitisation issuance, including with regard to the requirements in Article 6(2) on adverse selection. Where appropriate, the PRA expects SMFs to escalate issues related to oversight of securitisation issuance to the Board or a relevant sub-committee.

Insurance firms, reinsurance firms or ISPVs as originators

2.6 The PRA considers that insurance or reinsurance firms and ISPVs can be originators within the meaning of Article 2 (3) of the Securitisation Regulation. Article 2(12) (a) and (b) of this regulation makes clear that insurance or reinsurance undertakings can also be 'institutional investors' in securitisation. The PRA expects insurance and reinsurance firms, and ISPVs to consider whether any transactions, such as those which aim to refinance loans, exposures or receivables, by transforming them into tranched securities and including any internal restructurings, may be considered securitisations as defined in Article 2 (1) of this regulation. This regulation imposes a set of requirements on investors, originators, sponsors and securitisation special purpose entities (SSPEs) with which they are required to comply.

2.7 Insurance or reinsurance firms can be both originators and investors in the same securitisation transaction, such as an internal restructuring of exposures or receivables for capital efficiency or matching adjustment (MA) eligibility purpose. In such cases the insurance or reinsurance firm must comply with Articles 6, 7, 8 and 9 of the Securitisation Regulation as applicable. Where an insurance firm, reinsurance firm or ISPV identifies itself as the originator of a securitisation, it should inform its supervisor without undue delay.

2.8 Where the originator is also the sole investor in the transaction, the PRA expects that that firm may consider the information specified in Article 7(1)(a) and (e) as 'made available' to investors through internal reporting to appropriate committees or the management board, provided the reporting contains the required information.

Investor requirements

2.9 The PRA expects institutional investors which invest in securitisation to be able to demonstrate, on request that they have in place adequate due diligence arrangements, processes and mechanisms to ensure compliance with Article 5 of the Securitisation Regulation.

2.10 A firm that has delegated the authority to manage its investments to another institutional investor may instead evidence that it has instructed the managing party to fulfil the due diligence requirements on its behalf.

3 STS ABCP sponsors

3.1 This part of the statement is relevant to PRA-authorised CRD IV credit institutions.

3.2 A credit institution supervised under CRD IV may act as a sponsor for an STS ABCP programme using one of the following routes:

(i) The credit institution demonstrates to its competent authority that the support it provides to the programme would not endanger its solvency and liquidity, even in an extreme market stress (Article 25(3), subparagraph 1); or

(ii) The competent authority has determined on the basis of the review and evaluation referred to in Article 97(3) of CRD IV that the arrangements, strategies, processes and mechanisms implemented by that credit institution and the own funds and liquidity it holds ensure the sound management and coverage of its risks (Article 25(3), subparagraph 2).

3.3 The PRA is the competent authority for the purposes of Article 25(3) with respect to PRA-authorised CRD IV credit institutions.

Article 25(3) subparagraph 1

3.4 To demonstrate to the PRA that its role as an STS ABCP Sponsor under the Securitisation Regulation Article 25 will not endanger its solvency or liquidity, a firm should notify its usual supervisory contact, providing relevant information that should include:

(i) an assessment of the impact of full support on the firm's Total Capital Requirement on an individual and consolidated basis, both with and without STS status;

(ii) an assessment of the impact of full support on the firm's regulatory liquidity guidance and buffer resources, both with and without STS status; and

(iii) a summary of the programme features relevant to an understanding the assessment in (i) and (ii) above, including an assessment against STS requirements in Articles 25 and 26 of the Securitisation Regulation.

3.5 Where a firm seeks to set up a new conduit, or is proposing to sponsor an ABCP programme or transaction for the first time, it must provide its supervisors with the request sufficiently in advance of the execution of the transaction.

Article 25(3) subparagraph 2

3.6 For the purposes of being an STS ABCP sponsor, the PRA is unlikely to determine on the basis of the review and evaluation referred to in Article 97(3) of CRD IV that the arrangements, strategies, processes and mechanisms implemented by that credit institution and the own funds and liquidity it holds ensure the sound management and coverage of its risks, unless the firm is currently a sponsor for at least one ABCP programme. This may include any existing non-STS ABCP programme for which the firm wishes to seek STS status.

3.7 Where a firm seeks to make use of the route specified in Article 25(3) subparagraph 2, it should make a written request to its usual supervisory contact prior to or alongside the submission of either its internal capital adequacy assessment process (ICAAP) or internal liquidity adequacy assessment process (ILAAP) document. Where the information specified in 3.5 is not already available in the ICAAP or ILAAP document, the firm should also provide necessary information referenced in paragraph 3.5.

4 The CRR securitisation capital framework

4.1 This part of the statement is relevant to PRA-authorised CRD IV firms.

4.2 This part of the statement sets out the PRA's expectations of firms in respect of the CRR securitisation capital framework in the following sections:

(i) 'Hierarchy of methods' –with respect to the exercise of discretions which determine the methods applied for calculating securitisation Risk Weighted Exposure Amounts (RWEAs).

(ii) 'Interim mapping of External Credit Assessment Institutions (ECAIs) structured finance credit assessments to Credit Quality Steps (CQS)' — with the respect to the interim mapping of rating agency grades to CQS for the purposes of securitisation positions risk weighted under the External Ratings Based Approach (SEC-ERBA).

Hierarchy of methods

PRA discretions under the hierarchy of methods

4.3 CRR Article 254 introduces the hierarchy of methods for calculating securitisation RWEAs, summarised below:

(i) where the conditions set out in Article 258 are met, the Securitisation Internal Ratings Based Approach (the 'SEC-IRBA') in accordance with Articles 259-260;

(ii) where the SEC-IRBA may not be used, the Securitisation Standardised Approach (the SEC-SA) in accordance with Article 261-262; and

(iii) where the SEC-SA may not be used, the Securitisation External Ratings Based Approach (the 'SEC-ERBA') in accordance with Articles 263-264 for rated positions or positions in respect of which an inferred rating may be used.

4.4 Under CRR Articles 254(4) and 258(2), the PRA may use the following discretions, on a case-by-case basis:

(i) to prohibit firms from applying SEC-SA, when the risk-weighted exposure amount resulting from the application of the SEC-SA is not commensurate to the risks posed to the institution or to financial stability; and

(ii) to prohibit the use of SEC-IRBA where securitisations have highly complex or risky features.

4.5 When determining whether to exercise its discretion under Articles 254(4) and 258(2), the PRA will consider whether securitisations a firm is exposed to exhibit features which are not explicitly captured in the SEC-SA or SEC-IRBA methods. The PRA may also consider the appropriateness of underlying credit risk weights for the portfolio as reflected in the K_{SA} or K_{IRB} determined under Article 255.

4.6 The SEC-IRBA is sensitive to a wider range of inputs than the SEC-SA. Therefore where the presence of a highly complex or risky feature leads the PRA to exercise its discretion to preclude the use of the SEC-IRBA, the PRA is also likely to prohibit the use of the SEC-SA on the grounds that the risk weights under the SEC-SA are not commensurate to the risks posed to the institution.

4.7 The SEC-SA and SEC-IRBA methods can only recognise a defined number of items in their calculation of capital requirements, primarily focused on credit risk. These methods may fail to recognise the presence of non-credit risks. To an extent some additional non-credit risks which can arise from securitisation are reflected in the 'non-neutrality' of the securitisation capital framework.[1] However the level of non-neutrality is driven by pre-defined inputs (eg STS status).

4.8 When the SEC-SA or SEC-IRBA method is applied to a securitisation position, there is also a risk that the K_{SA} or K_{IRB} derived using the credit risk capital framework is inappropriate. This may be because the underlying exposures exhibit risk drivers which are not adequately captured by the credit risk framework.

4.9 Therefore in the presence of risk characteristics and structural features which are not explicitly captured in the formulas of the SEC-SA or SEC-IRBA, including features not adequately captured in the underlying credit risk framework, it is possible that an appropriate assessment by an ECAI takes into account those features. In such cases the SEC-ERBA may more appropriately reflect the risk posed to the institution.

4.10 Examples of features or characteristics which expose firms to risks not captured in the SEC-SA or SEC-IRBA include, but are not limited to, those listed in Article 258(2)(a) to (d), and:

(a) interest rate risks or Foreign Exchange risks which arise due to mismatches between the underlying pool and the issued notes, and which are not adequately hedged;

(b) features or characteristics which expose holders of securitisation notes to the risk that market conditions at the date of the sale or refinance of underlying exposures result in losses, such as exposure to residual value risk;

(c) portfolios which exhibit a high degree of single name, sectoral or geographical credit concentration risk;

1 'Non-neutrality' of the framework here means that typically the total risk-weighted exposure amounts calculated for the tranches of a securitisation will be higher than the risk-weighted exposure amounts calculated for the underlying portfolio had it not been securitised. In the SEC-SA and SEC-IRBA, this non-neutrality is introduced primarily through the application of a risk weight floor (10% for STS positions and 15% for non-STS positions) and the supervisory 'p' factor.

(d) portfolios where the underlying exposures may be highly correlated in the event of a stress;

(e) complex mechanisms which impact the priority of payments, for example the existence of turbo features; and

(f) for transactions to which the SEC-SA applies, where the characteristics of the underlying portfolio exhibit material dilution risk.

4.11 The PRA, in conjunction with the Financial Policy Committee (FPC) or on its own initiative, may identify financial stability risks arising from firms' securitisation activity. Where the RWEA calculated under the SEC-SA method is not commensurate to the risk posed to financial stability, the PRA may mitigate the risk by use of Article 254(4).

Information on methods used by firms

4.12 The PRA expects firms to have regard, during their ICAAP, to the provisions in Supervisory Statement (SS) 31/15 paragraphs 2.39 and 2.40.[1] The information provided in a firm's ICAAP document, supplemented by information received by other means such as regulatory reporting, will be used to assist the PRA in its assessment of whether firms' securitisation exposures using the SEC-SA or SEC-IRBA are appropriately capitalised.

4.13 The PRA may request further information from a firm. The PRA expects firms to provide this information within 20 business days, unless agreed otherwise.

4.14 This additional information may vary on a case by case basis, but should include:

(i) A list of the securitisation positions to which the SEC-SA or the SEC-IRBA is applied.

(ii) For each securitisation position listed in (i):

- the asset class of the underlying securitised exposures;
- the risk characteristics and structural features exhibited by the securitisation that may materially impact the performance of the firm's securitisation position, and which are not explicitly taken into account by the method applied;
- the risk weights for each securitisation position under the SEC-IRBA, SEC-SA and SEC-ERBA (insofar as each method can be used);
- a hyperlink to the prospectus of the transaction, or where no prospectus is available a copy of the offering circular or equivalent; and
- for rated securitisation positions, the latest rating(s) attributed to the position and the ECAI(s) which provided that rating.

1 SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', April 2018: www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.

Communication of decisions on the hierarchy of methods

4.15 Where the PRA considers that the exercise of its discretion under 254(4) or 258(2) is justified, it will inform the firm in writing.

4.16 The PRA may choose to exercise one or both of the discretions under Article 254(4) and 258(2) in respect of a securitisation position or a defined group of securitisation positions.

4.17 The PRA may choose to exercise the discretion under Article 254(4) to an unrated securitisation position for which a rating may not be inferred, in which case it may require the firm to apply a 1,250% risk weight to the securitisation position.

Firms' use of the CRR hierarchy

4.18 Relevant senior management should ensure that firms are using appropriate methods to capitalise their securitisation exposures.

4.19 For these purposes, relevant senior management means the individual(s) performing the relevant SMF(s), and employees subject to the Certification Regime involved in investment decisions in securitisation exposures (eg relevant Material Risk Takers (MRTs) under the Remuneration rules).

4.20 Under Article 254(3), firms may decide to apply the SEC-ERBA instead of the SEC-SA to all of their rated securitisations or positions in respect of which an inferred rating may be used.

4.21 Firms should notify the PRA of a decision made under CRR Article 254(3). That notification should be sent simultaneously via email to the [XXXX] inbox (XXXX@bankofengland.co.uk) and to the firm's usual supervisory contact. This notification should include information on the impact of such a decision on the firm's securitisation RWEAs.

Interim mapping of External Credit Assessment Institutions (ECAIs) structured finance credit assessments to Credit Quality Steps (CQS)

4.22 The CRR Article 270e requires the European Banking Authority (EBA) to produce Implementing Technical Standards (ITS) mapping the credit assessments of ECAIs to the CQS specified in the CRR for the purposes of calculating risk-weighted exposure amounts under the SEC-ERBA.

4.23 Prior to adoption of this ITS, PRA expects firms to use the illustrative Basel securitisation ERBA mapping for long-term ratings,[1] as set out in Table 1 below for long-term ratings. For short-term ratings, PRA expects firms to use the existing short-term mapping in Commission Implementing Regulation (EU) 2016/1801 on laying down technical standards with regard to the mapping of credit assessments for securitisation. These tables will be superseded once relevant ITS has been adopted.

1 Basel, July 2016, 'Revisions to the Securitisation Framework'. The rating designations referenced are for illustrative purposes only and do not indicate any preference for, or endorsement of, any particular external assessment system.

Table 1: Long-term ECAI assessment mapping

Credit Quality Step	Illustrative Rating
1	AAA / Aaa
2	AA+ /Aa1
3	AA / Aa2
4	AA- /Aa3
5	A+ / A1
6	A / A2
7	A- / A3
8	BBB+ / Baa1
9	BBB / Baa2
10	BBB- /Baa3
11	BB+ /Ba1
12	BB / Ba2
13	BB- / Ba3
14	B+ / B1
15	B / B2
16	B- /B3
17	CCC+/CCC/CCC- Caa1/Caa2/Caa3
18	Below CCC-/Caa3

Appendix 2: Draft amendments to Supervisory Statement 9/13 Securitisation: significant risk transfer[1]

This appendix outlines proposed amendments to Supervisory Statement 9/13, which is renamed 'Securitisation: significant risk transfer'. Underlining indicates proposed additions and striking through indicates proposed deletions.

1 Introduction

1.1 This part of the statement is ~~aimed at~~ relevant to PRA-authorised firms to which CRD IV applies.

1.2 This part of the statement sets out the Prudential Regulation Authority's (PRA's) expectations of firms in respect of securitisation in the following sections:

…

(7) 'Excess spread in SRT securitisations' – expectations of firms intending to use excess spread in SRT securitisations; and

(8) 'Assessment of Commensurate Risk Transfer (CRT) for portfolios of Standardised Approach (SA) exposures' – expectations of firms seeking to obtain SRT through securitisation of SA portfolios.

…

2 High-level Significant Risk Transfer considerations

…

2.3 One indication of whether or not risk transfer is commensurate is whether the RWEA post-securitisation is commensurate with the RWEA that would apply if the firm acquired the securitised exposures from a third party. The PRA expects firms purchasing risk transfer products to give adequate consideration to all relevant factors when assessing SRT, including the size of premiums paid and tranche thickness.

2.3a The PRA expects firms to consider if tranches that are sold, or tranches on which protection is purchased, are sufficiently thick such that the reduction in RWEAs can be justified by a commensurate transfer of risk to third parties. When considering thickness of tranches sold or on which protection is purchased, firms should take into account all relevant factors related to the portfolio of securitised exposures.

…

1 SS9/13 'Securitisation', July 2017: www.bankofengland.co.uk/prudential-regulation/publication/2013/securitisation-ss.

2.7 The PRA expects relevant senior management of a firm to be appropriately engaged in the execution of securitisation transactions that lead to a reduction in RWEA~~, where the firm is providing or purchasing structured trades~~.

(i) For the purposes of such transactions, 'relevant senior management' means any individuals performing Senior Management Functions (SMFs) with oversight of such transactions, and any employees subject to the Certification Regime involved in the transactions (eg relevant Material Risk Takers (MRTs) under the Remuneration rules).[1]

(ii) The level of senior management engagement may vary in line with the complexity of the transaction and the amount of reduction in RWEA. For transactions with complex structural features or risk characteristics that could materially affect the assessment of risk transfer or retention, the PRA expects oversight of these transactions to be linked to Prescribed Responsibility (PR) 7.

…

2.10 The PRA will seek to ensure that the securitisation framework is not used to undermine or arbitrage other parts of the prudential framework. In relation to other similar credit protection arrangements, including those subject to credit risk mitigation or trading book rules, the impact of certain features (eg significant premiums, ~~or~~ call options or excess spread) may cast doubt on the extent of risk transferred and the resulting capital assessment.[2] Features which result in inadequate capital requirements compared to the risks a firm is running may result in the credit protection not being recognised or the firm being subject to extra capital charges in their ~~Individual Capital Guidance (ICG)~~ Total Capital Requirement (TCR) in the form of Pillar 2 add-ons. Credit protection arrangements in general are subject to the same overarching principles as those in the securitisation framework.

…

3 Significant Risk Transfer notifications and permissions

…

Information to be provided

3.8 A firm's notification should include sufficient information to enable the PRA to assess whether the possible reduction in RWEA which would be achieved by the securitisation is justified by a commensurate transfer of credit risk to third parties. Consistent with Fundamental Rule 7, the PRA expects firms to be open and cooperative and disclose any relevant information of which the PRA would reasonably expect notice. The PRA expects such information to include at least the following:

…

1 SS28/15 'Strengthening Individual Accountability in Banking', May 2017: www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-banking-ss.

2 Article 194(2) of the CRR requires firms to, 'take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address the risks related to that arrangement'.

4 Regulatory capital calculation methodology and SRT

…

4.3 When evaluating SRT transactions which apply the Ratings Based Approach (RBA), the PRA will also have regard to whether the chosen credit rating agency has appropriate expertise in the asset class being rated, in accordance with Chapter 9 of the EBA Guidelines on Significant Risk Transfer.

…

7 Excess spread in SRT securitisations

7.1 The CRR defines excess spread as 'finance charge collections and other fee income received in respect of the securitised exposures net of costs and expenses'. The PRA recognises that excess spread can be formulated in a range of different ways, and expects firms to take a 'substance over form' approach to the treatment of excess spread features in SRT securitisations. The PRA considers that the presence of excess spread in synthetic securitisations (SES), when junior in the capital structure to sold or protected tranches, impacts the transfer of credit risk to third parties by providing credit enhancement, such that the protection buyer has retained risk.

7.2 If SRT transactions are structured such that SES provides credit enhancement, firms should assess the risks retained by SES, adequately quantify such risk, and reflect this retained risk in their post-transaction capital requirements. For the purposes of calculating capital requirements, the PRA considers it appropriate to treat SES as an off-balance sheet securitisation position.

7.3 Firms should measure the nominal value of the off-balance sheet securitisation position as a reasoned and prudent estimate of the credit enhancement provided by SES, for example as compared to a retained first loss tranche. Firms should apply a 1,250% risk weight to this nominal value, or alternatively deduct from capital.[1]

7.4 The presence of excess spread in traditional securitisations (TES) may, in certain transactions, impact the transfer of credit risk to third parties, where it is used to absorb losses thus providing credit enhancement to more senior tranches. In certain transactions, for example where the securitised exposures are sold at par value despite their fair value being higher than par, excess spread not eroded by losses can be extracted to the benefit of the originator as deferred consideration. In these circumstances, the PRA expects firms to treat the credit enhancement provided by TES in a similar manner to the approach described for SES, by measuring the credit enhancement provided and applying a 1,250% risk weight or deducting from capital accordingly.

1 Deduct securitisation positions from Common Equity Tier 1 items in accordance with CRR Article 36(1)(k).

8 Assessment of Commensurate Risk Transfer (CRT) for portfolios of Standardised Approach (SA) exposures

8.1 The PRA expects firms to consider the thickness of tranches sold to third parties or tranches on which protection is purchased, for portfolios of SA exposures, in a prudent manner. When justifying that commensurate risk has been transferred, the PRA expects firms to compare the detachment point (D) of tranches sold, or on which protection is purchased, against the K_{SA} (RWEA in respect of the underlying exposures as if they had not been securitised multiplied by 8% and divided by the value of the underlying exposures) of the portfolio.

8.2 The PRA considers it prudent to apply a scalar of 1.5 to K_{SA} to determine the minimum value of D for the purpose of justifying commensurate transfer of risk, unless firms can evidence that a lower scalar is appropriate for the particular transaction. The PRA will remain flexible in assessing firms' evidence for a reduced scalar to K_{SA} and will consider the use of external data sources where it is comparable and representative.

Appendix 3: Draft amendments to Supervisory Statement 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)'

This appendix outlines proposed amendments to Supervisory Statement 31/15. Underlining indicates proposed additions.

2 Expectations of firms undertaking an ICAAP

…

Exposures to securitisation

2.39 When a firm assesses risks associated with exposures to securitisation as part of their ICAAP, firms should consider the following:

(i) The risk characteristics and structural features of a securitisation, including those of the underlying exposures, which could materially impact the performance of any positions in that securitisation held by the firm;

(ii) Whether the application of another method, namely SEC-IRBA, SEC-ERBA or SEC-SA, insofar as that method may be used, would result in material differences in risk weights for a position relative to the method applied; and

(iii) The extent to which differences in risk-weights identified in (ii) may be caused by the risk characteristics and structural features identified in (i) as well as the approach taken by an External Credit Assessment Institution (ECAI) in rating a particular asset class.

2.40 A firm's record under Internal Capital Adequacy Assessment 13.1 of its approach to evaluating and managing securitisation risk (or credit risk arising from securitisation exposures) should cover the following issues as appropriate, taking into account SS9/13 'Securitisations: Significant Risk Transfer' :

(i) The appropriateness of the credit risk weight calculated for the asset classes to which the firm is exposed via securitisation;

(ii) Risk characteristics and structural features exhibited by securitisations to which the firm is exposed, that may materially impact the performance of the securitisation position, and are not explicitly taken into account by the method applied;

(iii) The risk-weighted exposure amounts for those positions, split by asset class or feature as appropriate, which would be arrived at under the SEC-IRBA, SEC-ERBA and the SEC-SA insofar as that method may be used; and

(iv) The firms' exposure to unrated securitisation positions.