

Bank of England PRA

Appendix 5: Draft amendments to supervisory statement 9/13 – Securitisation: Significant Risk Transfer

Draft supervisory statement

October 2024

Draft for consultation



Draft amendments to supervisory statement

9/13 – Securitisation: Significant Risk Transfer

In this appendix, new text is underlined and deleted text is struck through.

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1: Introduction

1.1 This statement applies to all firms to which the Securitisation (CRR) Part of the PRA Rulebook applies. ~~is relevant to PRA authorised firms to which CRD IV applies.¹~~

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

- (2) 'High-level Significant Risk Transfer considerations' — general expectations of firms seeking to obtain significant risk transfer (SRT) through securitisation;
- (3) 'Significant Risk Transfer notifications and permissions' — process for notifying the PRA of SRT transactions and for obtaining permission to undertake own assessments of SRT;
- (4) 'Regulatory capital calculation methodology and SRT' — methodologies firms use to calculate post-securitisation risk weights in SRT transactions;
- (4A) Use of unfunded credit protection for synthetic SRT securitisations;
- (5) 'Implicit Support and SRT' — the PRA's approach to implicit support;
- (6) 'High-cost credit protection and other SRT considerations' — factors likely to affect the assessment of SRT transactions;
- (7) 'Excess spread in SRT securitisations' – the PRA's approach to excess spread in SRT securitisations; and
- (8) 'Assessment of commensurate risk transfer (CRT) for portfolios of Standardised Approach (SA) exposures' – the PRA's approach to assessing CRT for SA portfolios.

¹ ~~On 20 July 2017, 15 November 2018, and 22 July 2020, this SS was updated — see the annex for full details.~~

1.3 The statement supplements the rules in the Securitisation (CRR) Part ~~the Benchmarking of Internal Approaches and Credit Risk Part~~ of the PRA Rulebook.

2: High-level Significant Risk Transfer considerations

2.1 The Securitisation (CRR) Part of the PRA Rulebook ~~CRR~~ requires any reduction in capital requirements achieved through securitisation to be justified by a commensurate transfer of risk to third parties. Where ~~the PRA determines that~~ the reduction in risk-weighted assets exposure amounts (RWEA), which would be achieved through a particular securitisation transaction, is not justified by a commensurate transfer of risk, then SRT shall not be considered to have been achieved by that transaction.

2.2 SRT is an ongoing requirement. Accordingly, the PRA expects firms to ensure that any reduction in capital requirements achieved through securitisation continues to be matched by a commensurate transfer of risk throughout the life of the transaction. The PRA expects firms to take a substance over form approach to assessing SRT. Firms should be able to demonstrate that the capital relief post-transaction adequately captures the economic substance of the entire transaction, and is commensurate to the retained risks.

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 tranches on which protection is purchased, firms should take into account all relevant factors related to the portfolio of securitised exposures.

2.4 When risk transfer transactions are structured as a group of linked transactions rather than a single transaction, the PRA expects the aggregate effect of linked transactions to comply with the Securitisation (CRR) Part of the PRA Rulebook ~~CRR~~. The PRA expects firms to ensure that analysis of risk transfer incorporates all linked transactions, particularly if certain transactions within a group of linked transactions are undertaken at off-market rates.

2.5 The PRA expects the instruments used to transfer credit risk not to contain provisions which materially limit the amount of risk transferred. For example, should losses or defaults

on the securitised exposures occur — ie deterioration in the credit quality of the underlying pool — the PRA expects the originator's net cost of protection or the yield payable to investors should not increase as a result.

2.6 In order to ensure their continuing appropriateness, the PRA expects firms to update the opinions of qualified legal counsel, required by the Securitisation (CRR) Part of the PRA Rulebook CRR, as necessary to ensure their continuing validity. For example, an opinion may need to be updated if relevant legal or regulatory statutory provisions are amended, or where a new decision or judgment of a court has a bearing on the continuing validity of counsel's opinion.

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.

- (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).²
- (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. The PRA expects oversight of these transactions to be linked to Prescribed Responsibility (PR) O (on 'managing the allocation and maintenance of the firm's capital, funding and liquidity') and, for small firms, to PR AA (on 'implementing and managing the firm's risk management policies and procedures') and to PR CC (on 'managing the firm's financial resources'). The oversight and approval of the features that affect commensurate risk transfer and, hence, the amount of reduction in RWA that may be achieved should be performed by the Chief Finance function (SMF 2) and any Senior Manager holding PR O, or AA and CC, if a different person. The PRA expects that the responsibility in relation to SRTs is reflected in the Statement of Responsibilities of the SMF 2 and any Senior Manager holding PR O, or AA and CC, if a different person. Please also refer to paragraph 3.8(aa) below on the PRA's expectations regarding attestation by the relevant SMF(s) as part of an SRT notification.~~

2.8 The PRA does not operate a pre-approval process for securitisation transactions. The PRA nevertheless expects a firm to discuss with its supervisor at an early stage securitisation transactions that are material or have complex features, including any non-sequential amortisation. Where a firm claims a regulatory capital reduction from securitisation transactions in its disclosures to the market, the PRA expects such disclosures to include

² Supervisory statement (SS) 28/15 – 'Strengthening Individual Accountability in Banking', May 2017; available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-banking-ss>.

caveats making clear the risk of full or partial re-characterisation where this risk is material in the light of the PRA's stated policy.

2.9 Although this supervisory statement sets out the PRA's expectations regarding securitisation, these expectations are also relevant for other similar credit protection arrangements.

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, call options or excess spread) may cast doubt on the extent of risk transferred and the resulting capital assessment.³ 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 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.

2.11 Where a firm achieves SRT for a particular transaction, the PRA expects it to continue to monitor risks related to the transaction to which it may still be exposed. The PRA expects firms to consider the capital planning implications of securitised assets returning onto their balance sheets. The Internal Capital Adequacy Assessment Part of the PRA Rulebook CRR requires firms to conduct regular stress testing of their securitisation activities and off balance sheet exposures.⁴ The PRA expects those stress tests to consider the firm-wide impact of stressed market conditions on those activities and exposures and the implications for other sources of risk, for example, credit risk, concentration risk, counterparty risk, market risk, liquidity risk and reputational risk. The PRA expects a firm's stress testing of securitisation activities to take into account existing securitisations and pipeline transactions. The PRA expects a firm to have in place procedures to assess and respond to the results of that stress testing and would expect them to be taken into account under Pillar 2.

(CRR Articles 243, 244 and 337 244 and 245 of the Securitisation (CRR) Part, Article 337 of the Market Risk: Simplified Standardised Approach (CRR) Part, and the Internal Capital Adequacy Assessment Part of the PRA Rulebook)

³ Article 194(2) of the Credit Risk Mitigation (CRR) Part of the PRA Rulebook 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 See also SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)'.

3: Significant Risk Transfer notifications and permissions

Requirements for originators to use securitisation risk weights

~~3.1 The CRR provides three options for firms to demonstrate how they transfer significant credit risk for any given securitisation transaction: Articles 244(2) and 245(2) of the Securitisation (CRR) Part of the PRA Rulebook state that significant credit risk will be considered as transferred in either of the following cases provided that the possible reduction in RWA is justified by a commensurate transfer of credit risk to third parties:~~

~~(1) the RWA of the mezzanine securitisation positions held by the originator institution in the securitisation do not exceed 50% of the RWA of all mezzanine securitisation positions existing in this securitisation; or the originator does not retain more than 50% of the risk weighted exposure amounts of mezzanine securitisation positions, where these are:~~

~~(i) positions to which a risk weight lower than 1,250% applies; and~~

~~(ii) more junior than the most senior position in the securitisation and more junior than any position in the securitisation rated Credit Quality Step 1 or 2.~~

~~(2) the originator institution does not hold more than 20% of the exposure value of the first loss tranche in the securitisation, provided that both of the following conditions are met:~~

~~(i) the originator can demonstrate that the exposure value of the first loss tranche exceeds a reasoned estimate of the expected loss on the underlying exposures by a substantial margin; and~~

~~(ii) there are no mezzanine securitisation positions. where there is no mezzanine position, the originator does not hold more than 20% of the exposure values of securitisation positions that are subject to a deduction or 1,250% risk weight and where the originator can demonstrate that the exposure value of such securitisation positions exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin; and~~

~~(3) Deleted. the competent authority may grant permission to an originator to make its own assessment if it is satisfied that the originator can meet certain requirements.~~

3.1A Article 245A of the Securitisation (CRR) Part of the PRA Rulebook requires a firm to notify the PRA of each transaction in relation to which it is relying on the deemed transfer of significant credit risk under Article 244(2) or Article 245(2).

3.1B The Securitisation (CRR) Part of the PRA Rulebook states that an originator institution must not recognise significant credit risk transfer where the PRA has imposed a requirement on the originator institution under section 55M of the Financial Services and Markets Act 2000 (FSMA) or a direction under section 192C of FSMA to preclude this. Please also refer to the PRA's statement of policy (SoP) 'The PRA's approach to the exercise of powers referred to in Articles 244(3)(b), 245(3)(b), 254(4) and 258(2) of the Securitisation (CRR) Part of the PRA Rulebook' in this regard.

3.1C The Securitisation (CRR) Part of the PRA Rulebook provides that, by derogation from Article 244(2) or Article 245(2), an originator institution may recognise significant credit risk transfer in relation to a securitisation where it has received the prior permission of the PRA under section 138BA FSMA. Please also refer to the SoP 'The PRA's approach to waivers and permissions under the Securitisations (CRR) Part of the PRA Rulebook' in this regard.

(Articles 244, 245 and 245A of the Securitisation (CRR) Part and Article 337 of the of the Market Risk: Simplified Standardised Approach (CRR) Part of the PRA Rulebook)

SRT under options (1) and (2)

This section has been deleted.

~~3.2 Credit Risk 3.1 in the PRA Rulebook requires a firm to notify the PRA of each transaction on which it seeks capital relief under options 1 and 2.~~

~~3.3 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.~~

~~(CRR Articles 243, 244 and 337)~~

SRT option 3

This section has been deleted.

~~3.4 The PRA intends to grant permission for an originator to make its own assessment of SRT only where it is satisfied that:~~

- ~~• in every relevant case, the reduction in capital requirements achieved would be justified by a commensurate transfer of risk to third parties;~~
- ~~• the firm has in place appropriately risk-sensitive policies and methodologies to assess the transfer of risk; and~~

- ~~such transfer of risk to third parties is also recognised for the purposes of the firm's internal risk management and internal capital allocation.~~

~~3.5 Where the PRA grants permission for multiple transactions, that permission will cover a defined scope of potential transactions. The permission will enable a firm (within certain limits) to carry out these transactions without notifying the PRA in each individual instance.~~

~~(CRR Articles 243, 244 and 337)~~

Deduction or 1,250% risk weighting Exemption from notification of significant risk transfer

3.6 A firm would not need to make a notification under Article 245A of the Securitisation (CRR) Part of the PRA Rulebook when it is either (1) seeking to achieve capital relief by deducting or applying a 1,250% risk weight to all retained positions where permitted under CRR Article 243 or 244 Articles 244(1)(b) or 245(1)(b) of the Securitisation (CRR) Part of the PRA Rulebook or (2) risk-weighting a position in a qualifying securitisation under Article 260A or Article 262A of the Securitisation (CRR) Part ~~would not need to make a notification under Credit Risk 3.1.~~ In such cases, a firm should consider whether the characteristics of the transaction are such that the PRA would reasonably expect prior notice of it.

~~(CRR Articles 243, 244~~ 244, 245, 245A, 260A and 262A of the Securitisation (CRR) Part of the PRA Rulebook)

SRT Notifications

Process for submitting notifications

3.7 When informing the PRA of a transaction in accordance with the Securitisation (CRR) Part of the PRA Rulebook ~~Credit Risk 3.1~~, the information should be sent simultaneously via email to the SRT notifications inbox SRT@bankofengland.co.uk and to the firm's usual supervisory contact.

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 RWA 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:

- (aa) a summary of the transaction that contains sufficient information for the PRA to understand its structure, economics and regulatory implications, including an

attestation by the relevant SMF(s) referred to in the penultimate sentence of paragraph 2.7(ii) that the information provided in the summary is accurate and complete and that SRT has been achieved;

- (a) details of the securitisation positions, including rating, exposure value and RWA broken down by securitisation positions sold and retained;
- (b) a copy of the SRT policy applied to the transaction, including details of the methodology and any models used to assess risk transfer;
- (c) a statement of how all relevant risks are incorporated into the SRT assessment and how the full economic substance of the transaction is taken into consideration;
- (d) the SRT calculation, setting out why the firm believes the capital relief proposed is commensurate with the credit risk transferred to third parties;
- (e) details of reliance on external credit assessment institutions (ECAIs) in the SRT assessment;
- (f) a description of the risks being retained;
- (g) key transaction documentation and any relevant supporting documents ~~(eg a summary of the transaction);~~
- (h) copies of investor and internal presentations on the transaction;
- (i) details of the underlying assets (including asset class, geography, tenor, rating, spread, collateral, exposure size);
- (j) details of the transaction structure;
- (k) details of any termination options (eg call options);
- (l) details of the cash flow between parties involved in the transaction;
- (m) details of the ratings and pricing of bonds issued in the transaction;
- (n) details of any connected parties involved in the transaction;
- (o) details of the rationale for the transaction;
- (p) details of the rules in the ~~CRR~~ Securitisation (CRR) Part of the PRA Rulebook that the firm is relying on;
- (pp) a comparison with relevant previous transactions, highlighting changes that may be relevant to the PRA's assessment and commenting on their rationale; and
- (q) details of the governance process for the transaction, including details of any committees involved in approving the transaction.

Communicating PRA decisions feedback on notified transactions

3.9 Following review of sufficient information provided by the firm, the PRA will ~~inform~~ provide feedback as appropriate to the firm on the PRA's ~~of its~~ view on commensurate risk transfer.

The PRA's review will focus on the proportion of credit risk transferred — including any transaction features which undermine effective risk transfer — compared to the proportion by which RWA is reduced as a result of the transaction. ~~Where the PRA judges the reduction in RWEA not to be justified by a commensurate transfer of credit risk to third parties, it will inform the firm that SRT has not been achieved by this transaction. Otherwise the PRA will inform the firm that it does not object to the transaction.~~

3.10 The PRA does not intend to pre-approve transactions. Instead, the PRA will provide a view feedback on whether it considers commensurate risk transfer to have been achieved at a point in time, which may be ~~provided~~ after a transaction has closed. The PRA may reassess its judgement of the achievement of commensurate risk transfer if the level of credit risk transfer in a transaction changes materially.

3.10A Please also refer to paragraph 3.1B above and the PRA's SoP 'The PRA's approach to the exercise of powers referred to in Articles 244(3)(b), 245(3)(b), 254(4) and 258(2) of the Securitisation (CRR) Part of the PRA Rulebook'.

Permissions for own assessment of SRT

This section has been deleted.

3.11 Firms may apply for permission to consider ~~SRT to have been achieved without needing to rely on option (1) or (2). The scope of such permission may be defined to cover a number of transactions or an individual transaction. (CRR Articles 243 and, 244 and 337)~~

Multiple transaction permissions

3.12 ~~Where a firm applies for such permission, the PRA expects the scope to be defined according to a range of characteristics, including the type of asset class and the structural features of the transaction. The characteristics that the PRA expects a firm to consider when defining the scope of a permission application include:~~

- ~~(a) asset class (eg residential or commercial mortgages, credit card receivables, leasing, loans to corporates or small and medium-sized enterprises, consumer loans, trade receivables, securitisations, Private Finance Initiative, insurance, covered bonds, other assets);~~
- ~~(b) further asset class distinction (eg geography and asset quality); and~~
- ~~(c) structural features (eg distinguishing between securitisation and re-securitisation, traditional and synthetic securitisation and non-revolving structures and revolving structures).~~

~~3.13 It is likely to be more straightforward for the PRA to assess applications for relatively narrowly scoped permissions than those covering a wide range of assets and/or with complex structural features.~~

~~PRA areas of review and information to be submitted by firms~~

~~3.14 In order to assess a firm's ability to use its own policies and methodologies for assessing SRT, the PRA's permission application reviews will focus on the following factors:~~

- ~~• the firm's understanding of the risk of potential transactions within the scope of the permission, including potential underlying assets, securitisation structures and other relevant factors that affect the economic substance of risk transfer;~~
- ~~• the firm's governance around SRT assessment (including sign off procedures) and systems and controls relating to risk transfer assessment and determination of SRT; • SRT calculation policies and methodologies, including models used;~~
- ~~• the firm's historical experience with relevant securitisation origination; and~~
- ~~• the use of third party risk assessments (eg external ECAI ratings) and the relationship with internal assessments.~~

~~3.15 The information the PRA expects a firm to provide in a permission application includes the following:~~

- ~~(a) details of the firm's governance processes for SRT, including details of any relevant committees and the seniority and expertise of key persons involved in sign off;~~
- ~~(b) a copy of the firm's SRT policy, including details of the SRT calculation policies, methodologies and any models used to assess risk transfer (this should set out how the firm ensures it only takes capital relief in proportion to the amount of risk transferred on any given transaction);~~
- ~~(c) a statement of how all relevant risks are incorporated in the SRT calculations and how the full economic substance of transactions is taken into consideration;~~
- ~~(d) details of the firm's systems and controls regarding risk transfer in securitisations;~~
- ~~(e) a copy of the firm's capital allocation strategy;~~
- ~~(f) details of any securitised assets that have come back on the firm's balance sheet and the reason why; and~~
- ~~(g) details of reliance on ECAs in determining SRT.~~

~~Limits attached to multiple transaction permissions~~

~~Materiality~~

~~3.16 The PRA will apply two materiality limits to the proportion of RWEA reduction that can be taken under any permission covering multiple transactions:~~

- (a) ~~transaction level limit~~—any transaction that would in principle be within the scope of the permission, but that resulted in an RWEA reduction exceeding 1% of the firm's credit risk related RWEAs, as at the date of the firm's most recent regulatory return, will fall outside the scope of a multiple transaction permission and will require a separate permission or require notification (if the transaction would satisfy option 1 or 2); and
- (b) ~~aggregate limit~~—once the aggregate RWEA reduction on all SRT transactions executed within the scope of a permission exceeds 5% of the firm's credit risk related RWEAs as at the date of the firm's most recent regulatory return, no additional transactions may be executed within scope of the permission. In such circumstances, a firm should take one of the following actions:
 - (i) ~~apply to renew the multiple transaction permission;~~
 - (ii) ~~apply for a new permission covering the specific transactions exceeding the RWEA limit; or~~
 - (iii) ~~notify the PRA of the transaction, following the SRT notification procedure (if the transactions would satisfy option 1 or 2).~~

Length of permission

3.17 ~~Multiple transaction permissions will be granted for a period of one year. The PRA's review of permission renewal will focus on changes to the firm's SRT policies and methodologies since the previous review.~~

Individual transaction permissions

3.18 ~~Permissions relating to individual transactions need not be granted prior to the execution of a transaction. The PRA does not intend to specify the timeframe in which a firm should submit an individual transaction permission application, but firms should note that capital relief from a specific transaction will not be available until a firm has obtained permission covering the SRT assessment and capital treatment (unless the transaction is being notified under option 1 or 2, or falls within scope of a multiple transaction permission).~~

3.19 ~~The information the PRA expects to receive in an individual transaction permission includes the items set out in paragraph 3.8 points (d) to (p), and paragraph 3.15 points (a) to (c).~~

Limits attached to individual transaction permissions

3.20 ~~The PRA may grant an individual permission for the full duration of a transaction, or may impose a shorter time limit on the permission. Where a firm seeks to take capital relief on a transaction beyond the expiry date of the relevant permission, the permission will require renewal prior to expiry.~~

3.21 ~~As SRT should be met on a continuing basis, permissions will typically include a requirement to notify the PRA of changes in circumstances from those under which the~~

~~permission was granted. Any reduction in credit risk transfer subsequent to the permission being granted will require the firm to make a commensurate reduction in the extent of RWEA reduction that is recognised. If a firm does not effect a commensurate reduction in the RWEA relief in such circumstances, the PRA may revoke the relevant permission.~~

~~(CRR Articles 243, 244 and 337)~~

4: Regulatory capital calculation methodology and SRT

4.1 Originators must transfer a significant amount of credit risk associated with securitised exposures to third parties to be able to apply the securitisation risk weights set out in ~~Chapter 5 of the CRR~~ the Securitisation (CRR) Part of the PRA Rulebook, and any associated reduction in capital requirements must be matched by a commensurate transfer of risk to third parties.

4.2 As part of the notification and permissions process, the PRA expects a firm to inform it of the methodology the firm intends to use to calculate securitisation capital requirements. The PRA will generally be more sceptical of the achievement of commensurate risk transfer for transactions where the regulatory capital calculation used produces very low capital requirements. Where the method used to calculate regulatory capital requirements post-securitisation results in a particularly significant reduction in capital requirements, the PRA will apply a high degree of scrutiny in its assessment of whether commensurate risk transfer is achieved.

4.3 When evaluating SRT transactions which apply the Securitisation External Ratings Based Approach (SEC-ERBA), 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.~~

4.4 Pending further international regulatory guidance, the PRA considers it appropriate to clarify its interpretation of the Loss Given Default (LGD) value firms should use for the purpose of calculating regulatory capital requirements using SEC-IRBA, for SRT securitisations of income-producing real estate (IPRE) assets where firms have adopted the slotting approach. For this purpose, the PRA expects firms to use the LGD value specified in CRR Article 259(6) of the Securitisation (CRR) Part of the PRA Rulebook.

~~(CRR Articles 243, 244 and 337 and Chapter 9 of EBA Guidelines on Significant Risk Transfer (EBA/GL/2014/05)~~ 244 and 245 of the Securitisation (CRR) Part and Article 337 of the Market Risk: Simplified Standardised Approach (CRR) Part of the PRA Rulebook)

Draft for consultation

4A: Use of unfunded credit protection for synthetic SRT securitisations

4A.1 Originators may use either funded credit protection or unfunded credit protection to achieve SRT where relevant requirements and supervisory expectations are met.

4A.2 The use of unfunded credit protection for synthetic SRT securitisations can pose additional prudential risks relative to funded credit protection. These include:

(i) a potentially higher risk of late payment or non-payment of the credit protection amount when a borrower or counterparty defaults; and

(ii) a risk that the unfunded credit protection provider may be downgraded and then cease to be eligible to provide unfunded credit protection, necessitating alternative arrangements to continue to achieve SRT. The PRA therefore considers the use of unfunded credit protection for SRT to be a complex feature for purposes of paragraph 2.8 above.

4A.3 The PRA also reminds originators using unfunded credit protection for SRT to comply with:

- the requirements in the Credit Risk Mitigation (CRR) Part of the PRA Rulebook relating to the use of unfunded credit protection and the related supervisory expectations in SS17/13 – ‘Credit risk mitigation’⁵;
- the requirements relating to unfunded credit protection for SRT in Article 249 of the Securitisation (CRR) Part of the PRA Rulebook, including the requirements regarding the ECAI rating of the protection provider; and
- the stress-testing rules in the Internal Capital Adequacy Assessment Part of the PRA Rulebook and related supervisory expectations in paragraph 2.11 of this SS.

4A.4 The PRA expects originators, as part of the monitoring and stress-testing mentioned in paragraph 2.11 of this SS, to assess the risk of a downgrade of the protection provider and the implications for the effectiveness of the unfunded credit protection and the eligibility of the provider to continue to provide the unfunded credit protection, and to reflect this in their capital planning.

(Articles 244, 245 and 249 of the Securitisation (CRR) Part, Article 337 of the Market Risk: Simplified Standardised Approach (CRR) Part, and the Internal Capital Adequacy Assessment Part of the PRA Rulebook.)

⁵ Available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/credit-risk-mitigation-ss>.

5: Implicit support and SRT

5.1 The PRA will monitor the support provided by a firm to its securitisation transactions, and will consider this carefully in the assessment of commensurate risk transfer. As part of firms' ongoing consideration of risk transfer, the PRA expects them to consider the support they have provided to securitisation transactions.

5.2 If a firm is found to have provided support to a securitisation, the expectation that the firm will provide future support to its securitisations is increased. The PRA will take account of this increased expectation in future assessments of commensurate risk transfer for that firm.

5.3 The PRA expects securitisation documentation to make clear, where applicable, that repurchase of securitisation positions by the originator beyond its contractual obligations is not mandatory and may only be made at arm's length.

5.4 Deleted

5.5 If a firm fails to comply with CRR Article 248(4) 250(1) of the Securitisation (CRR) Part of the PRA Rulebook, the PRA may require it to disclose publically that it has provided non-contractual support to its transaction.

~~(CRR Articles 243, 244, 248 and 337 and CRD4 Article 98, EBA guidelines on implicit support for securitisation transactions (EBA/GL/2016/08) 244, 245 and 250 of the Securitisation (CRR) Part, Article 337 of the of the Market Risk: Simplified Standardised Approach (CRR) Part, and the Internal Capital Adequacy Assessment Part of the PRA Rulebook.)~~

6: High-cost credit protection and other SRT considerations

6.1 Some transactions transfer little or no economic risk from the protection buyer to the protection seller, but may nevertheless result in a reduction in regulatory capital requirements. An example of such a transaction-type is one in which protection is purchased on a junior tranche and a high premium is paid for that protection.

6.2 Generally, the amount of premium paid will not materially affect the assessment of whether SRT is achieved. This is because either:

- the protection payment payable upon default from protection seller to protection buyer is significantly larger than the overall premium payable to the protection seller; or
- the payment of premium leads to an immediate incurred cost.

6.3 However, there comes a point at which the premium payable for protection can reduce significantly the economic risk that is transferred from the protection buyer to protection seller. A premium payable of 100% of the protection amount could leave the protection buyer in a position over the life of the transaction that was no better than if protection had not been purchased.

6.4 The PRA expects originators seeking to apply the securitisation risk weights to synthetic securitisations to take into account all relevant factors to assess the extent of risk transferred. As well as the size and timing of amounts payable to the protection seller, the circumstances in which those amounts are payable can undermine the effectiveness of risk transfer. The PRA expects firms seeking capital relief through synthetic securitisations to incorporate premiums in their assessment of SRT. In particular, the following transaction features may have a significant impact on the extent of risk transfer:

- premium which is guaranteed in all or almost all circumstances, eg premium which is payable upfront or deferred;
- those that could result in the amount of premium payable for protection being significantly greater than the spread income on the assets in the portfolio or similar to the size of the hedged position; and
- those under which the protection buyer retains the expected loss through higher transaction costs to the counterparty, in the form of premium or otherwise.

6.5 Originators should have regard to the statement on high cost credit protection issued by the Basel Committee on Banking Supervision (www.bis.org/publ/bcbs_n16.htm).

6.6 The Securitisation (CRR) Part of the PRA Rulebook ~~CRR~~ requires maturity to be assessed in considering SRT. When assessing the effective maturity of synthetic securitisations, the PRA expects firms to consider whether the transaction contains an option to terminate the protection at the discretion of the protection buyer. The PRA will consider the following to be examples of features which generally indicate a positive incentive for the protection buyer to call a transaction, or at least to constitute grounds for discussion with the PRA prior to the conclusion of the transaction:

- the transaction contains terms, such as payments at maturity or payments upon early termination or significant premiums, which may reduce risk transfer;
- the transaction includes a requirement for the protection buyer to incur additional costs or obligations if they do not exercise their option to terminate the protection; and

- there are pre-agreed mechanisms, for example ‘at-market unwinds’, where the protection seller and protection buyer agree that the transaction can be terminated in the future at a ‘market’ value and specifies aspects of how the value is calculated.

(~~CRR Articles 243, 244 and 337~~ 244 and 245 of the Securitisation (CRR) Part and Article 337 of the Market Risk: Simplified Standardised Approach (CRR) Part of the PRA Rulebook.)

7: Excess spread in SRT securitisations

7.1 No standardised definition of excess spread exists in market practice, however it can be considered 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 (subject to Article 253 of the Securitisation (CRR) Part of the PRA Rulebook) apply a 1,250% risk weight to this nominal value, or ~~alternatively~~ deduct from capital.⁶

7.4 The presence of excess spread in traditional securitisations (TES) may, in certain transactions where accounting derecognition has not been achieved, impact the transfer of credit risk to third parties, where it is used to absorb losses thus providing credit enhancement to more senior tranches. The PRA is primarily concerned where the excess spread results from the securitised exposures being sold below their market value, for instance, where 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 (subject to Article 253 of the Securitisation

⁶ Deduct securitisation positions from Common Equity Tier 1 items in accordance with ~~CRR Article 36(1)(k)~~ of the Own Funds (CRR) Part of the PRA Rulebook.

(CRR) Part of the PRA Rulebook) applying a 1,250% risk weight or deducting from capital accordingly. The PRA is open to considering alternative methods for firms to measure the credit enhancement provided. As the PRA considers excess spread a complex feature, firms may approach the PRA to discuss potential transactions with such a feature ahead of execution, as set out in paragraph 2.8.

(CRR Articles 242, 243 and 244, 245 and 253 of the Securitisation (CRR) Part of the PRA Rulebook)

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 for firms 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. The PRA considers the 1.5 scalar to K_{SA} to be a prudent fall-back and will consider a lower scalar to K_{SA} , if firms can evidence this is more appropriate for a 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.

(CRR Articles 243 and 244 and 245 of the Securitisation (CRR) Part of the PRA Rulebook)