

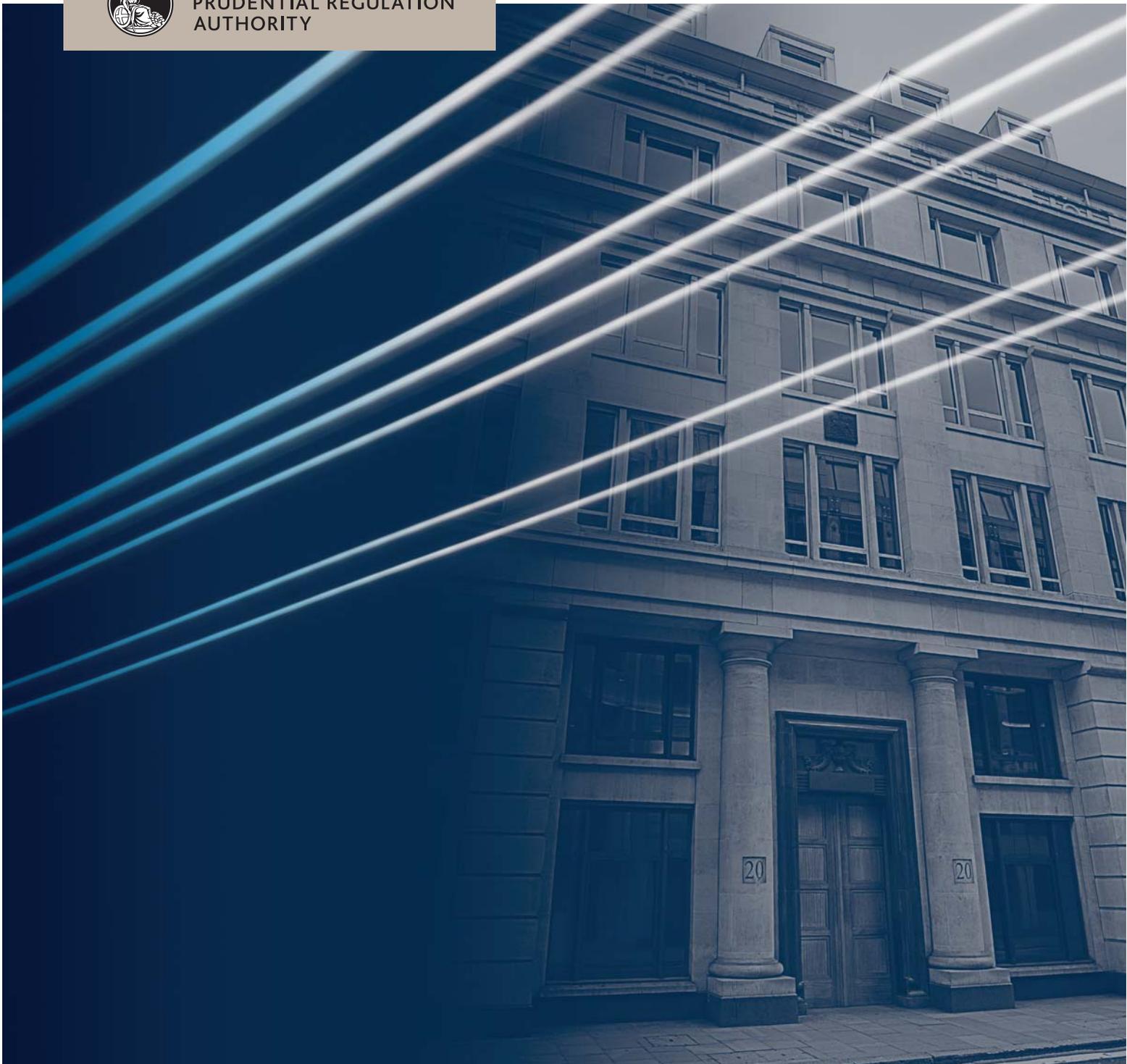
Supervisory Statement | LSS11/13

Securitisations: significant risk transfer waivers and notifications

April 2013



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



19 December 2013 - this document has been superseded, see
<http://www.bankofengland.co.uk/pr/Pages/publications/securitisation.aspx>



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From its commencement on 1 April 2013, the Prudential Regulation Authority (PRA) has adopted a number of legacy FSA policy publications relevant to the advancement of its objectives. This document, initially issued by the FSA, has been adopted by the PRA as a Supervisory Statement as part of this process. The PRA may choose to review this legacy publication at a later stage.

The significant risk transfer (SRT) waivers and notifications requirements under the Banking Consolidation Directive (BCD) came into force on 31 December 2010.

These requirements provide several options for firms to demonstrate how they transfer significant credit risk for any given transaction.

- For information on the requirements for SRT notifications and how to comply with them, see our SRT notifications — quick reference guide.
- For information on the requirements for SRT waivers and how to comply with them, see our SRT waivers — quick reference guide.

Options for demonstrating SRT under the BCD

In accordance with Part 2 of Annex IX of the Banking Consolidation Directive (BCD), firms have the following options to transfer significant credit risk for any given transaction:

- (1) The originator does not retain more than 50% of the risk weighted exposure amounts of mezzanine securitisation positions, where these are:
 - positions to which a risk weight lower than 1250% applies; and
 - 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) 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 1250% risk weight and where the originator can demonstrate that the exposure value of such securitisation

- positions exceeds (by a substantial margin) a reasoned estimate of the expected loss on the securitised exposures.
- (3) The competent authority may allow an originator to make its own assessment if it is satisfied that the originator can meet certain requirements.
 - (4) The originator applies a 1250% risk weight to all retained positions.
 - (5) The originator deducts all retained positions from capital resources.

We have implemented these options in BIPRU 9.3, 9.4 and 9.5.

Requirements for using each of the options

Options 1 and 2

Options 1 and 2 can be found in BIPRU 9.3.7R. A firm seeking to demonstrate SRT via either of these options is required to notify the PRA of each transaction on which it is seeking capital relief.

As set out in BIPRU 9.3.9G — where we decide that the possible reduction in risk-weighted exposures amounts achieved via the securitisation is not justified by a commensurate transfer of credit risk to third parties — we will use our powers under section 55J of the Financial Services and Markets Act 2000 (FSMA) to require the firm to increase its risk-weighted exposure amounts to a level that is commensurate with our assessment of the transfer credit risk to third parties.

Option 3

A firm may only use option 3 where — in accordance with BIPRU 9.3.10G and BIPRU 9.3.11D — it has first obtained a waiver from the PRA for each transaction on which it is seeking capital relief. Under this option, the firm must demonstrate to us that:

- it has policies and methodologies in place that ensure the possible reduction of capital requirements achieved by the originator through securitisation is justified by a commensurate transfer of credit risk to third parties; and
- such transfer of credit risk to third parties is also recognised for the firms internal risk management and internal capital allocation.

The waiver may be granted for multiple transactions, in which case it will cover a defined scope of potential transactions and will enable a firm (within certain limits) to carry out

transactions covered by the waiver without notifying us of each individual transaction.

Options 4 and 5

A firm seeking to achieve capital relief via options 4 or 5 is not required to comply with the notification and waiver requirements. However, for any given transaction using options 4 or 5, a firm should consider whether any characteristics of the transaction would be something we would reasonably expect notice of and require disclosure of under Principle for Business 11 (PRIN 2.1.1R).

Quick reference guide SRT notifications

This is a short guide to the new requirements regarding significant risk transfer (SRT) notifications and how you can ensure your firm is complying with them.

Requirements relating to SRT notifications can be found in BIPRU 9.3.7R to BIPRU 9.3.9G, BIPRU 9.4.11R–BIPRU 9.4.13G and BIPRU 9.5.1R (6) to BIPRU 9.5.1R (7) and BIPRU 9.5.1FG.

Process for submitting notifications

Within one month of a securitisation transaction closing, a firm will be required to notify the PRA of the transaction if it has relied on options 1 or 2 to achieve SRT.

The notification should be sent simultaneously via email to the SRT notifications inbox (SRT@bankofengland.co.uk) and the firm's regular supervisory contact.

Information to be notified

The PRA Handbook provisions in BIPRU 9.3.8R, BIPRU 9.4.12R and BIPRU 9.5.1R (7) outline information that must be included in an SRT notification. We expect firms to supply the information in the following (non-exhaustive) list to satisfy these requirements:

- Key transaction documentation.
- Details of the governance process for the transaction, including details of any committees involved in approving the transaction.
- A copy of the SRT policy applied to the transaction, including details of the methodology and any models used to assess risk transfer.
- The SRT calculation, setting out why the firm believes the capital relief proposed is commensurate with the credit risk transferred to third parties.
- 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.

- Details of the BIPRU rules the firm is relying on.
- Copies of investor and internal presentations on the transaction.
- Details of the rationale for the transaction.
- Details of the underlying assets (including asset class, geography, tenor, rating, spread, collateral, exposure size).
- Details of the transaction structure.
- A description of the risks being retained.
- Details of the cashflow between parties involved in the transaction.
- Details of the ratings and pricing of bonds issued in the transaction.
- Details of any connected parties involved in the transaction.
- Details of any termination options (eg call options).
- Details of reliance on external credit assessment institutions (ECAIs) in the SRT assessment.

Communicating PRA decisions on notified transactions

As set out in BIPRU 9.3.9G, where we decide that the reduction in risk-weighted exposure amounts that the firm seeks to achieve by using options 1 or 2 is not justified by a commensurate transfer of credit risk to third parties, we will use our powers under section 55J of FSMA to require the firm to increase its risk-weighted exposure amounts to a level that is commensurate to our assessment of the transfer credit risk to third parties. The way we determine commensurate transfer of credit risk to third parties will focus on the proportion of credit risk transferred, compared to the proportion by which risk-weighted exposure amounts are reduced in the transaction.

We do not intend to pre-approve transactions. We will provide a point-in-time view on whether we consider that commensurate risk transfer has been achieved, and this may be given after a transaction has closed. As SRT needs to be achieved on an ongoing basis, we retain the power to reassess our view if the level of credit risk transfer in a transaction changes over time.

Quick reference guide

SRT waivers

This is a short guide to the new requirements regarding significant risk transfer (SRT) waivers and how you can ensure your firm is complying with them.

Processing waiver applications

We will process firms' applications as quickly as possible, but given the potential complexity of SRT waiver applications this may take longer than would otherwise be the case.

Publishing waiver directions

We expect to publish in full waiver directions that cover multiple transactions. We recognise that waiver directions covering individual transactions may be more likely to be commercially sensitive and we would consider this when determining the content of published individual waiver directions. However, should any firm submitting an individual transaction waiver object to the publication of the waiver, they should make this clear in their application in accordance with SUP 8.6.7G.

How do you apply for a waiver?

Please apply for SRT waivers using the normal PRA waivers application procedures and submit your application to PRA-Waivers@bankofengland.gsi.gov.uk.

Multiple transaction waivers

Requirements relating to multiple transaction waivers can be found in BIPRU 9.3.10G to BIPRU 9.3.14G, BIPRU 9.4.14G to BIPRU 9.4.18G and BIPRU 9.5.1AG to BIPRU 9.5.1EG.

Scope of multiple transaction waivers

We are not pre-specifying the categories of multiple transaction waivers that firms may apply for. We believe this would result in an overly rigid framework that may not usefully reflect the specific types of securitisations any given firm is involved/ has expertise in. Instead, we are providing firms with the flexibility to scope their own waiver applications, subject to certain parameters. The scope should be defined according to a range of criteria, including the type of asset class and the structural features of the transaction. A non-exhaustive list of issues for firms to consider when scoping a waiver application is set out below:

Asset class — for example:

- residential mortgages;
- commercial mortgages;
- credit card receivables;

- leasing;
- loans to corporates or small and medium-sized enterprises (SMEs);
- consumer loans;
- trade receivables;
- securitisations;
- Private finance initiative (PFI);
- insurance;
- other assets;
- covered bonds; and
- other liabilities.

Further asset class distinction — for example:

- geography (eg distinguish between US and UK residential mortgage backed securities (RMBS)); and
- asset quality (eg distinguish between commercial mortgage backed securities (CMBS) of different loan to values (LTVs)).
- Structural features — for example, by distinguishing between:
 - securitisation and re-securitisation;
 - traditional and synthetic securitisation; and
 - non-revolving structures and revolving structures.

We intend to be flexible in our review process so that waivers that are narrowly scoped in terms of asset categories and structure types will be subject to a proportionate approval process that reflects their lower complexity and that is relative to waivers covering a wide range of assets and/or with complex structural features. Firms should present their preferred waiver scope to us. We are likely to reject any application that we consider to be scoped more widely than a firm's competencies.

PRA areas of review and information to be submitted by firms

So that we can be comfortable that a firm is able to use its own policies and methodologies for assessing SRT, our waiver reviews will focus on:

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

We would expect to receive the following information in a waiver application (this list is non-exhaustive):

- A completed waiver application form, including the firm's arguments under the statutory tests in section 138A of FSMA;
- 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;
- Details of the firm's systems and controls regarding risk transfer in securitisations;
- 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;
- 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;
- A copy of the firm's capital allocation strategy;
- Details of any securitised assets that have come back on the firm's balance sheet and the reason why; and
- Details of reliance on ECAs in determining SRT.

Limits attached to multiple transaction waivers

Materiality

Two materiality limits will be applied to the proportion of risk-weighted exposure amount (RWEA) relief that can be taken under any waiver covering multiple transactions:

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

Length of waiver

Multiple transaction waivers will be granted for one year. The review of waiver renewals will focus on any changes to the firm's SRT policies and methodologies since the previous review.

Individual transaction waivers

Requirements relating to SRT individual transaction waivers can be found in BIPRU 9.3.10G to BIPRU 9.3.14G, BIPRU 9.4.14G to BIPRU 9.4.18G and BIPRU 9.5.1AG to BIPRU 9.5.1EG.

Unlike multiple transaction waivers, waivers relating to individual transactions do not need to be granted before the execution of a transaction. We do not intend to specify the timeframe in which a firm should submit an individual transaction waiver, but we note that a firm will not be able to take capital relief from a specific transaction until it has a waiver in place 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 waiver).

The information we would expect to receive in an individual transaction waiver is a mixture of that required under the notification requirement and that for multiple transaction waivers. A non-exhaustive list of documents that we would expect to receive is given below:

- A completed waiver application form, including the firm's arguments under the statutory tests in section 138A of FSMA.
- Key transaction documentation.
- Details of the governance processes for the transaction, including details of any committees involved in approving the deal.
- A copy of the SRT policy applied to the transaction, including details of the methodology and any models used to assess risk transfer.
- The SRT calculation setting out why the firm believes the capital relief proposed is commensurate with credit risk transferred to third parties.
- A statement of how all relevant risks are incorporated in the SRT assessment and how the full economic substance is taken into consideration.
- Details of the BIPRU rules the firm is relying on.
- Copies of investor and internal presentations on the transaction.
- Details of the rationale for the transaction.
- Details of the underlying assets (including asset class, geography, tenor, rating, spread, collateral, exposure size).
- Details of the transaction structure.
- A description of the risks being retained.
- Details of the cashflow between parties involved in the transaction.
- Details of the ratings and pricing of bonds issued in the transaction.
- Details of any connected parties involved in the transaction.
- Details of any early termination options (eg call options).
- Details of reliance on ECAs in the SRT assessment.

Limits attached to individual transaction waivers

Depending on the nature of the transaction, we may grant an individual waiver for the life of the transaction, or we may impose a time limit on the waiver period. Where a firm is seeking to take capital relief on a transaction beyond the expiry date of the waiver applying it, the firm would need to renew the waiver as it approached the expiry date.

Given that SRT should be met on an ongoing basis, waivers will typically include a requirement to notify us of any change in circumstances from those under which the waiver was granted (for example, where the amount of credit risk transfer had changed materially). Any reduction in credit risk transfer subsequent to the granting of the waiver would require the firm to take a commensurate reduction in RWEA relief or otherwise the PRA may revoke the waiver.