Financial Services Commission

Guidance Note

Capital Requirements Directive - Securitisation

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V3

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Table of Contents

1. Application and purpose

1.1 This Guidance Note applies to all locally incorporated credit institutions and investment firms who use securitisation positions in accordance with the Capital Adequacy Directive, comprising Directive 2006/48/EC and Directive 2006/49/EC which have been implemented in Gibraltar via the Banking (Capital Adequacy of Credit Institutions) Regulations, 2006 and Financial Services (Capital Adequacy of Investment Firms) Regulations 2007. The aim of the Guidance Note is to supplement the Regulations in setting the standards for the measurement of securitisation positions and how firms must calculate these.

1.2 A firm must calculate the risk-weighed exposure amount for securitisation positions in accordance with this Guidance Note.

1.3 A firm should apply the securitisation framework set out in this section for determining regulatory capital requirements on exposures arising from traditional securitisations, from synthetic securitisations and from structures that contain features of both.

1.4 Since securitisations may be structured in many different ways, the capital treatment of a securitisation position should be determined on the basis of its economic substance rather than merely its legal form. A firm should look to the economic substance of a transaction to determine whether the securitisation framework is applicable for purposes of determining regulatory capital. A firm should consult the FSC when there is uncertainty about whether a given transaction should be considered a securitisation. For example, transactions involving cash flows from real estate (e.g. rents) may be considered specialised lending exposures, if warranted.

2. General obligations on Systems

2.1 The risks arising from securitisation transactions in relation to which a firm is originator or sponsor must be evaluated and addressed through appropriate policies and procedures, to ensure in particular that the economic substance of the transaction is fully reflected in the risk assessment and management decisions.

2.2 A firm that is a party to a securitisation should fully understand the risks it has assumed or retained. In particular it should do so in order that it can correctly determine in accordance with this Guidance Note the capital effects of the securitisation.

2.3 The FSC expects an originator to continue to monitor any risks that it may be subject to when it has excluded the securitised exposures from its calculation of risk-weighted exposure amounts. The originator should consider capital planning implications where risks may return and the impact that securitisation has on the quality of the remaining exposures held by the originator.

3. Trading book and non trading book

3.1 This Guidance Note deals with:

3.1.1 requirements for originators and sponsors of securitisations of non-trading book exposures; and

3.1.2 the requirements for securitisation positions in the non-trading book.

4. Implicit support

4.1 An originator which, in respect of a securitisation, has made use of paragraph 5.1.1 in the calculation of risk-weighted exposure amounts, or a sponsor, must not, with a view to reducing potential or actual losses to investors, provide support to the securitisation beyond its contractual obligations.

4.2 If an originator or sponsor fails to comply with paragraph 4.1 in respect of a securitisation, it must :

4.2.1 hold capital against all of the securitised exposures associated with the securitisation transaction as if they had not been securitised; and

4.2.2 disclose publicly:

4.2.2.1 that it has provided non-contractual support, and

4.2.2.2 the regulatory capital impact of doing so.

4.3 In accordance with paragraph 4.1, the securitisation documentation should make clear that any repurchase of securitised exposures or securitisation positions by the originator or sponsor is not mandatory and where it occurs it will be done at fair market value. In general, any repurchase should be subject to a firm's credit review and approval process, which should be adequate for ensuring that any repurchase is in accordance with paragraph 4.1.

4.4 In addition, an originator or sponsor should only repurchase exposures if it would be able to satisfy the FSC, if asked, that it has adequately considered the following:

4.4.1 the price of the repurchase;

4.4.2 the firm's capital and liquidity position before and after repurchase;

4.4.3 the performance of the securitised exposures; and

4.4.4 the performance of the issued securities;

and has concluded that, taking into account those factors and any other relevant factors, the repurchase is not structured to provide support.

4.5 A firm should make and retain adequate records of the matters in paragraph 4.3 and paragraph 4.4 including:

4.5.1 any repurchase referred to in 4.3; and

4.5.2 its consideration of the matters in 4.4.

4.6 For the purposes of paragraph 4.2.2 firms will be expected to include disclosure of implicit support in accordance with the general and technical requirements on public disclosure.

4.7 One of the main purposes of prohibiting the support referred to in paragraph 4.1 is that such support might increase expectation that the firm will provide future support to its securitisations thus failing to achieve a significant transfer of risk or misstating the degree of risk transfer.

4.8 There are three main cases to consider:

4.8.1 support given under a contractual obligation;

4.8.2 support given under the contractual documentation for the securitisation which the firm is entitled, but not obliged, to give; and

4.8.3 support which is not provided for under the contractual documentation for the securitisation.

4.9 Support described in paragraph 4.8.1 is permitted by paragraph 4.1. Support described in paragraph 4.8.3 is not permitted by paragraph 4.1. Support described in paragraph 4.8.2 may be permitted by paragraph 4.1 under the following conditions:

4.9.1 the fact that the firm may give it is expressly set out in the contractual and marketing documents for the securitisation;

4.9.2 the nature of the support that the firm may give is precisely described in the documentation referred to in 4.9.1;

4.9.3 the maximum degree of support that can be given can be ascertained at the time of the securitisation both by the firm and by a person whose only information comes from the marketing documents for the securitisation;

4.9.4 the assessment of whether there has been significant risk transfer and the amount of that transfer assumes that the firm will provide support to the maximum degree as referred to in 4.9.3; and

4.9.5 the firm's capital resources and capital resources requirement are adjusted at the time of the securitisation to reflect what would be the effect of giving the maximum degree of support as referred to in paragraph 4.9.3 at once, whether by an immediate deduction from capital or otherwise.

4.10 For example, the conditions in paragraph 4.9 could be satisfied by support given by waiving the right to future margin income. This is because:

4.10.1 although the amount of support that can be given may not be ascertainable at the start of the transaction in absolute monetary terms, the degree of support can be defined precisely by reference to the contractual documentation; and

4.10.2 it is possible to make the adjustment in paragraph 4.9.5 in precise quantitative terms because the capital effect of giving support in that form is nil, as a firm should not in any case reflect future margin income in its income or capital resources.

4.11 Approach to be used:

4.11.1 Where a firm uses the standardised approach set out in the Guidance Note on Credit Risk Standardised Approach for the calculation of risk-weighted exposure amounts for the standardised credit risk exposure class to which the securitised exposures would otherwise be assigned under the credit risk standardised approach, then it must calculate the risk-weighted exposure amount for a securitisation position in accordance with the standardised approach to securitisations set out in section 11 of this Guidance Note, subject to paragraphs 9.12 to 9.14.

4.11.2 In all other cases it must calculate a risk-weighted exposure amount in accordance with the IRB approach to securitisations set out in section 11 of this Guidance note, subject to paragraphs 9.12 to 9.14.

5. Requirements for originators

5.1 Where significant credit risk associated with securitised exposures has been transferred from the originator in accordance with the terms of sections 6 or 7, that originator may:

5.1.1 in the case of a traditional securitisation, exclude from its calculation of risk-weighted exposure amounts and, as relevant, expected loss amounts, the exposures which it has securitised; and

5.1.2 in the case of a synthetic securitisation, calculate risk-weighted exposure amounts and, as relevant, expected loss amounts in respect of such exposures, in accordance with the provisions of section 7.

5.2 Where paragraph 5.1 applies, the originator must calculate the risk-weighted exposure amounts prescribed in this section for the positions it may hold in the securitisation.

5.3 Where the originator fails to transfer significant credit risk in accordance with paragraph 5.1 it need not calculate risk-weighted exposure amounts for any positions it may hold in the securitisation in question.

5.4 Subject to paragraph 5.8, for the purposes of paragraphs 6.1 and 7.1 the transfer of credit risk to third parties should only be considered significant if the proportional transfer of risk is broadly commensurate with, or exceeds, the proportional reduction in risk-weighted exposure amounts.

5.5 If the result of applying a risk weight of 1250% to all positions that a firm holds in the securitisation or, as provided for by section 14, deducting all those positions from capital resources results in a reduction in the firm's capital requirement compared to the capital requirements that would apply if it had not transferred the securitised exposures, the firm may treat significant risk as having been transferred for the purpose of paragraphs 6.1 and 7.1.

5.6 For measuring the reduction in risk and risk-weighted exposure amounts, an originator should assess the securitisation positions it holds against the underlying exposures as if they had never been securitised.

5.7 The proportion of risk transferred should be assessed via an appropriate method consistent with the firm's own internal processes.

5.8 If an originator transfers risk in relation to securitised exposures but the technique used to do the securitisation may not be fully effective in accordance with sections 6 or 7, the originator should not deal with that by adjusting the proportional transfer of risk under paragraph 5.4 to reflect the uncertainties. Instead the originator should treat the terms of sections 6 or 7, as the case may, as not having been satisfied.

5.9 Firms should consult with the FSC if additional guidance is required.

6. Traditional securitisation

Minimum requirements for recognition of significant credit risk transfer

6.1 The originator credit institution of a traditional securitisation may exclude securitised exposures from the calculation of risk-weighted exposure amounts and expected loss amounts if either of the following conditions is fulfilled:

6.1.1 significant credit risk associated with the securitised exposures is considered to have been transferred to third parties;

6.1.2 the originator credit institution applies a 1 250 % risk weight to all securitisation positions it holds in this securitisation or deducts these securitisation positions from own funds according to Article 57 (r).';

6.2 Unless the FSC decides in a specific instance that the possible reduction in risk weighted exposure amounts which the originator credit institution would achieve by this securitisation is not justified by a commensurate transfer of credit risk to third parties, significant credit risk shall be considered to have been transferred in the following cases:

6.2.1 the risk-weighted exposure amounts of the mezzanine securitisation positions held by the originator credit institution in this securitisation do not exceed 50 % of the risk weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;

6.2.2 where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from own funds or a 1 250 % risk weight exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the originator credit institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from own funds or a 1 250 % risk weight.

6.3 For the purposes of point 1a, mezzanine securitisation positions mean securitisation positions to which a risk weight lower than 1 250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation position in this securitisation to which:

6.3.1 in the case of a securitisation position subject to points 6 to 36 of part 4 a credit quality step 1; or

6.3.2 in the case of a securitisation position subject to points 37 to 76 of part 4 a credit quality step 1 or 2 is assigned under Part 3.

6.3A As an alternative to points 6.2 and 6.3 significant credit risk may be considered to have been transferred if the competent authority is satisfied that a credit institution has policies and methodologies in place, ensuring that the possible reduction of capital requirements which the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties. The competent authorities shall only be satisfied if the originator credit institution can demonstrate that such transfer of credit risk to third parties is also recognised for purposes of the credit institution's internal risk management and its internal capital allocation.

6.3B In addition to the points above, all the following conditions shall be met:

6.4 Legal opinions should be reviewed as necessary to ensure continuing enforceability.

6.5 The securities issued must not represent payment obligations of the originator.

6.6 The transferee must be a securitisation special-purpose entity.

6.7 The originator must not maintain effective or indirect control over the transferred exposures (see also paragraph 6.10).

6.8 Where there is a clean-up call option, the following conditions must be satisfied:

6.8.1 the clean-up call option is exercisable at the discretion of the originator;

6.8.2 the clean-up call option may only be exercised when 10% or less of the original value of the exposures securitised remains unamortised; and

6.8.3 the clean-up call option is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement.

6.9 The securitisation documentation must not contain clauses that:

6.9.1 other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator including but not limited to altering the underlying credit exposures or increasing the yield payable to investors in response to a deterioration in the credit quality of the securitised exposures; or

6.9.2 increase the yield payable to holders of positions in the securitisation in response to deterioration in the credit quality of the underlying pool.

6.10 For the purposes of paragraph 6.7, an originator will be considered to have maintained effective control over the transferred exposures if it has the right to repurchase from the transferee the previously transferred exposures in order to realise their benefits or if it is obligated to re-assume transferred risk. The originator's retention of servicing rights or obligations in respect of the exposures does not of itself constitute indirect control of the exposures.

7. Synthetic securitisation

7.1 Minimum requirements for recognition of significant credit risk transfer:

7.1.1 An originator credit institution of a synthetic securitisation may calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with paragraphs 7.2 and 7.3, if either of the following is met:

7.1.1.2 Significant credit risk is considered to have been transferred to third parties either through funded or unfunded credit protection.

7.1.1.3 the originator credit institution applies a 1 250 % risk weight to all securitisation positions he holds in this securitisation or deducts these securitisation positions from own funds according to Article 57 (r) of Directive 2006/48/EC.

7.1.1.4 Unless the FSC decides on a case- by-case basis that the possible reduction in risk weighted exposure amounts which the originator credit institution would achieve by this securitisation is not justified by a commensurate transfer of credit risk to third parties, significant credit risk shall be considered to have been transferred if either of the following conditions is met:

7.1.1.4.1 the risk-weighted exposure amounts of the mezzanine securitisation positions which are held by the originator credit institution in this securitisation do not exceed 50 % of the risk weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;

7.1.1.4.2 where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from own funds or a 1 250 % risk weight exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the originator credit institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from own funds or a 1 250 % risk weight.

7.1.1.5 For the purposes of point 7.1.1.4, mezzanine securitisation positions means securitisation positions to which a risk weight lower than 1 250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation positions in this securitisation to which:

7.1.1.5.1 in the case of a securitisation position subject to points 6 to 36 of part 4 of Directive 2006/48/EC a credit quality step 1; or

7.1.1.5.2 in the case of a securitisation position subject to points 37 to 76 of part 4 of Directive 2006/48/EC a credit quality step 1 or 2 is assigned under Part 3.

7.1.1.6 As an alternative to points 7.1.1.4 and 7.1.1.5, significant credit risk may be considered to have been transferred if the competent authority is satisfied that a credit institution has policies and methodologies in place to ensure that a possible reduction of capital requirements that the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties. The competent authorities shall only be satisfied if the originator credit institution can demonstrate that such transfer of credit risk to third parties is also recognised for purposes of the credit institutions internal risk management and its internal capital allocation.

7.1.1.7 In addition, the transfer shall comply with the following conditions:

7.1.2 The securitisation documentation must reflect the economic substance of the transaction.

7.1.3 The credit protection by which the credit risk is transferred must comply with the eligibility and other requirements under Credit risk mitigation and, so far as applicable, under the Guidance Note on the IRB Approach to credit risk mitigation for the recognition of such credit protection. For these purposes, securitisation special purpose entities must not be recognised as eligible unfunded protection providers.

7.1.4 The instruments used to transfer credit risk must not contain terms or conditions that:

7.1.4.1 impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;

7.1.4.2 allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;

7.1.4.3 other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator; or

7.1.4.4 increase the originator's cost of credit protection or the yield payable to holders of positions in the securitisation in response to deterioration in the credit quality of the underlying pool.

7.1.4.5 An opinion must be obtained from qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.

7.1.5 Originators' calculation of risk-weighted exposure amounts for exposures securitised in a synthetic securitisation.

7.2 Paragraphs 7.2 to 7.7 apply to the calculation by an originator of risk-weighted exposure amounts for exposures securitised in a synthetic securitisation.

7.2.1 In calculating risk-weighted exposure amounts for the securitised exposures, where the conditions in paragraph 7.1 are met, the originator of a synthetic securitisation must, subject to the treatment of maturity mismatches set out in paragraphs 7.5 to 7.7, use the relevant calculation methodologies set out in section 10 to section 14 and not those set out in the Guidance Note for Credit Risk Standardised Approach or IRB Approach.

7.2.2 For firms calculating risk-weighted exposure amounts and expected loss amounts under the IRB approach, the expected loss amount in respect of such exposures must be zero.

7.2.3 For clarity, this paragraph refers to the entire pool of exposures included in the securitisation.

7.3 Subject to the treatment of maturity mismatches set out in paragraphs 7.5 to 7.8, the originator must calculate risk-weighted exposure amounts in respect of all tranches in the securitisation in accordance with the provisions of section 10 to section 14. For example, where a tranche is transferred by means of unfunded credit protection to a third party, the risk weight of that third party must be applied to the tranche in the calculation of the originator's risk-weighted exposure amounts. Treatment of maturity mismatches in synthetic securitisations.

7.4 Paragraphs 7.5 to 7.7 apply to the treatment of maturity mismatches in a synthetic securitisation.

7.5 For the purposes of calculating risk-weighted exposure amounts in accordance with paragraph 7.2, any maturity mismatch between the credit protection by which the tranching is achieved and the securitised exposures must be taken into consideration in accordance with paragraphs 7.6 to 7.7.

7.6 The maturity of the securitised exposures must be taken to be the longest maturity of any of those exposures subject to a maximum of five years. The maturity of the credit protection must be determined in accordance with Schedule 8 pf the BCACI Regulations and, so far as is relevant, the Guidance Note on the IRB Approach to credit risk.

7.7 An originator must ignore any maturity mismatch in calculating risk-weighted exposure amounts for tranches appearing pursuant to section 11 or section 12 with a risk weight of 1250%. For all other tranches the maturity mismatch treatment must be applied in accordance with:

RW* is [RW(SP) x (t-t*)/(T-t*)] + [RW(Ass) x (T-t)/(T-t*)]

7.7.1 The following apply for the purposes of the above formula:

7.7.2 RW* is risk-weighted exposure amounts;

7.7.3 RW(Ass) is risk-weighted exposure amounts for exposures if they had not been securitised calculated on a pro-rata basis;

7.7.4 RW(SP) is risk-weighted exposure amounts calculated under paragraph 7.2.1 as if there was no maturity mismatch;

7.7.5 T is maturity of the underlying exposures expressed in years;

7.7.6 t is maturity of credit protection. expressed in years; and

7.7.7 t* is 0.25.

8. Recognition of credit assessments of ECAIs

8.1 An ECAI's credit assessment may be used to determine the risk weight of a securitisation position in accordance with this Guidance Note only if the ECAI is an eligible ECAI.

8.2 A firm may not use for the purpose described in paragraph 8.1 a credit assessment of an eligible ECAI unless it complies with the principles of credibility and transparency as elaborated in the remainder of this section.

8.3 There must be no mismatch between the types of payments reflected in the credit assessment and the types of payment to which the firm is entitled under the contract giving rise to the securitisation position in question.

8.4 The credit assessment must be available publicly to the market. Credit assessments may only be treated as publicly available if:

8.4.1 they have been published in a publicly accessible forum, and

8.4.2 they are included in the ECAI's transition matrix.

8.5 Credit assessments that are made available only to a limited number of entities may not be treated as publicly available.

9. Use of ECAI credit assessments for the determination of applicable risk weights

9.1 The use of ECAIs' credit assessments for the calculation of a firm's risk-weighted exposure amounts under this Guidance Note must be consistent and in accordance with paragraphs 9.2 to 9.7. Credit assessments must not be used selectively.

9.2 A firm may nominate one or more eligible ECAIs the credit assessments of which must be used in the calculation of its risk-weighted exposure amounts (a nominated ECAI).

9.3 Subject to paragraphs 9.5 to 9.6.3, a firm must use credit assessments from nominated ECAIs consistently in respect of its securitisation positions.

9.4 Subject to paragraphs 9.5 and 9.6, a firm must not use an ECAI's credit assessments for its positions in some tranches and another ECAI's credit assessments for its positions in other tranches within the same structure that may or may not be rated by the first ECAI.

9.5 In cases where a position has two credit assessments by nominated ECAIs, the firm must use the less favourable credit assessment.

9.6 In cases where a position has more than two credit assessments by nominated ECAIs, the two most favourable credit assessments must be used. If the two most favourable assessments are different, the less favourable of the two must be used.

9.6.1 Where credit protection eligible under Schedule 8 of the BCACI Regulations and Section 10 of the Guidance Note on the IRB Approach to credit risk is provided directly to the SSPE (Securitisation Special Purpose Entity), and that protection is reflected in the credit assessment of a position by a nominated ECAI, the risk weight associated with that credit assessment may be used.

9.6.2 If the protection is not eligible under Schedule 8 of the BCACI Regulations the credit assessment must not be recognised.

9.6.3 In the situation where the credit protection is not provided to the SSPE but rather is provided directly to a securitisation position, the credit assessment must not be recognised.

10. Calculation of risk-weighted exposure amounts for securitisation positions

10.1 To calculate the risk-weighted exposure amount of a securitisation position, the relevant risk weight must be applied to the exposure value of the position in accordance with sections 10 to 14 based on the credit quality of the position.

10.2 For the purpose of paragraph 10.1, the credit quality of a position may be determined by reference to an ECAI credit assessment or otherwise, as set out in sections 10 to 14.

10.2.1 Where there is an exposure to different tranches in a securitisation, the exposure to each tranche must be considered a separate securitisation position.

10.2.2 The providers of credit protection to securitisation positions must be treated as holding positions in the securitisation.

10.2.3 Securitisation positions include exposures to a securitisation arising from interest rate or currency derivative contracts.

10.3 Subject to paragraph 10.4:

10.3.1 where a firm calculates risk-weighted exposure amounts under the standardised approach to securitisations outlined in section 11, the exposure value of an on-balance sheet securitisation position must be its balance sheet value;

10.3.2 where a firm calculates risk-weighted exposure amounts under the IRB approach to securitisations outlined in section 12, the exposure value of an on-balance sheet securitisation position must be measured gross of value adjustments;

10.3.3 the exposure value of an off-balance sheet securitisation position must be its nominal value multiplied by a conversion figure as prescribed in this section; and

10.3.4 the conversion figure referred to in 10.3.3 must be 100% unless otherwise specified.

10.4 The exposure value of a securitisation position arising from a derivative instrument must be determined in accordance with relevant practices.

10.5 Where a securitisation position is subject to funded or unfunded credit protection the risk weight to be applied to that position may be modified in accordance with Schedule 8 of the BCACI Regulations read in conjunction with section 13.

10.6 Where a firm has two or more overlapping positions in a securitisation the firm must, to the extent that the positions overlap, include in its calculation of risk-weighted exposure amounts only the position, or portion of a position, producing the higher risk-weighted exposure amounts.

10.7 For the purpose of paragraph 10.6, overlapping means that the positions, wholly or partially, represent an exposure to the same risk such that to the extent of the overlap there is a single exposure.

11. Calculation of risk weighted exposure amounts under the standardised approach to securitisations

11.1 Subject to paragraph 11.5, the risk-weighted exposure amount of a rated securitisation position must be calculated by applying to the exposure value the risk weight associated with the credit quality step with which the credit assessment has been determined to be associated, as prescribed in tables 11.2 or 11.3.

11.2 Table: Positions other than ones with short-term credit assessments.

Credit Quality step	1	2	3	4	5 and below
Risk Weight	20%	50%	100%	350%	1250%

11.3 Table: Positions with short-term credit assessments.

Credit Quality step	1	2	3	All other credit assessments
Risk Weight	20%	50%	100%	1250%

11.4 Subject to paragraphs 11.6 to 11.14, the risk-weighted exposure amount of an unrated securitisation position must be calculated by applying a risk weight of 1250%.

Originator and sponsor firms

11.5 For an originator or sponsor, the risk-weighted exposure amounts calculated in respect of its positions in a securitisation may be limited to the risk-weighted exposure amounts which would be calculated for the securitised exposures had they not been securitised subject to the presumed application of a 150% risk weight to all past due items and items belonging to regulatory high risk categories (regulatory high risk categories) amongst the securitised exposures.

Treatment of unrated securitisation positions

11.6

11.6.1 A firm having an unrated securitisation position may apply the treatment set out in this paragraph for calculating the risk-weighted exposure amount for that position provided the composition of the pool of exposures securitised is known at all times.

11.6.2 A firm may apply the weighted-average risk weight that would be applied to the securitised exposures referred to in 11.6.1 under the standardised approach by a firm holding the exposures multiplied by a concentration ratio.

11.6.3 This concentration ratio is equal to the sum of the nominal amounts of all the tranches divided by the sum of the nominal amounts of the tranches junior to, or pari passu with, the tranche in which the position is held including that tranche itself.

11.6.4 The resulting risk weight must not be higher than 1250% or lower than any risk weight applicable to a rated more senior tranche.

11.6.5 Where the firm is unable to determine the risk weights that would be applied to the securitised exposures under the standardised approach, it must apply a risk weight of 1250% to the position.

11.7 This paragraph contains guidance on the requirement in paragraph 11.6.1 that the composition of the pool of exposures securitised referred to in that paragraph is known at all times. The composition should be known sufficiently at the time of purchase for the firm to be able accurately to calculate the risk-weighted exposure amounts of the pool under the standardised approach. Thereafter, any change to the composition of the pool during the life

of the transaction that would lead to an increase in the risk-weighted exposure amounts of the pool of exposures under the standardised approach should be either:

11.7.1 prohibited by the documentation; or

11.7.2 included in the firm's capital calculations.

11.8 Where appropriate it would be sufficient for the purposes of paragraph 11.7 for the composition of the pool to be reported to the firm at least daily, via information service providers, secure web-sites or other appropriate sources.

11.9 Treatment of securitisation positions in a second loss tranche or better in an ABCP programme.

11.10 Subject to the availability of a more favourable treatment by virtue of the provisions concerning liquidity facilities in paragraphs 11.12 to 11.14, a firm may apply to securitisation positions meeting the conditions set out in paragraph 11.11 a risk weight that is the greater of:

11.10.1 100%; or

11.10.2 the highest of the risk weights that would be applied to any of the securitised exposures under the standardised approach by a firm holding the exposures.

11.11 For the treatment in paragraph 11.10 to be available:

11.11.1 the securitisation position must be in an ABCP programme;

11.11.2 the securitisation position must be in a tranche which is economically in a second loss position or better in the securitisation and the first loss tranche must provide meaningful credit enhancement to the second loss tranche;

11.11.3 the securitisation position must be of a quality the equivalent of investment grade or better; and

11.11.4 the firm in question must not hold a position in the first loss tranche.

Treatment of unrated liquidity facilities

11.12 When the following conditions are met, to determine its exposure value a conversion figure of 50% may be applied to the nominal amount of a liquidity facility:

11.12.1 the liquidity facility documentation must clearly identify and limit the circumstances under which the facility may be drawn;

11.12.2 the facility must not be able to be drawn so as to provide credit support by covering losses already incurred at the time of draw – for example, by providing liquidity in respect of exposures in default at the

time of draw or by acquiring assets at more than fair value;

11.12.3 the facility must not be used to provide permanent or regular funding for the securitisation;

11.12.4 repayment of draws on the facility must not be subordinated to the claims of investors other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;

11.12.5 it must not be possible for the facility to be drawn after all applicable credit enhancements from which the liquidity facility would benefit are exhausted; and

11.12.6 the facility must include a provision that results in an automatic reduction in the amount that can be drawn by the amount of exposures that are in default, where default has the meaning given to it for the purposes of the IRB approach, or where the pool of securitised exposures consists of rated instruments, that terminates the facility if the average quality of the pool falls below investment grade.

Cash advance facilities

11.13 To determine its exposure value, a conversion figure of 0% may be applied to the nominal amount of a liquidity facility that is unconditionally cancellable provided that the conditions set out in paragraph 11.12 are satisfied and that repayment of draws on the facility are senior to any other claims on the cash flows arising from the securitised exposures.

12. Calculation of risk-weighted exposure amounts under the internal ratings based approach

12.1 This section applies to the calculation of risk-weighted exposure amounts of securitisation positions under the IRB approach.

Hierarchy of methods

12.2 For a rated position or a position in respect of which an inferred rating may be used, the ratings based method must be used to calculate the risk-weighted exposure amount.

12.3 For an unrated position the supervisory formula method (see paragraphs 12.36 and 12.37) must be used except where a firm uses the ABCP internal assessment approach.

12.4 In cases where both the ABCP internal assessment approach and the supervisory formula method are available, a firm should choose its preferred approach and apply that approach consistently across transactions.

12.5 A firm other than an originator or a sponsor may not use the supervisory formula method unless its IRB permission expressly permits it to do so.

12.6 Subject to any IRB permission of the type described in paragraph 12.43, in the case of an originator or sponsor unable to calculate KIRB and which has not obtained approval to use the ABCP internal assessment approach, and in the case of other firms where they have not obtained approval to use the supervisory formula method or, for positions in ABCP programmes, the ABCP internal assessment approach, a risk weight of 1250% must be applied to securitisation positions which are unrated and in respect of which an inferred rating may not be used.

Use of inferred ratings

12.7 When the following minimum operational requirements are satisfied a firm must attribute to an unrated position an inferred credit assessment equivalent to the credit assessment of those rated positions (the 'reference positions') which are the most senior positions which are in all respects subordinate to the unrated securitisation position in question:

12.7.1 the reference positions must be subordinate in all respects to the unrated securitisation tranche;

12.7.2 the maturity of the reference positions must be equal to or longer than that of the unrated position in question; and

12.7.3 on an ongoing basis, any inferred rating must be updated to reflect any changes in the credit assessment of the reference securitisation positions.

Maximum risk-weighted exposure amounts

12.8 For an originator, a sponsor, or for other firms which can calculate KIRB, the risk-weighted exposure amounts calculated in respect of its positions in a securitisation may be limited to that which would produce an amount in respect of its credit risk capital requirement equal to the sum of 8% of the risk-weighted exposure amounts which would be produced if the securitised assets had not been securitised and were on the balance sheet of the firm plus the expected loss amounts of those exposures.

Ratings based method

12.9 Paragraphs 12.10 to 12.19 apply to the calculation of risk-weighted exposure amounts of securitisation positions under the ratings based method.

12.10 Under the ratings based method, the risk-weighted exposure amount of a rated securitisation position must be calculated by applying to the exposure value the risk weight associated with the credit quality step with which the credit assessment is associated as prescribed in table 12.11 and table 12.12 multiplied by 1.06.

12.11 Table: Positions other than ones with short-term credit assessments

Credit Quality Step (CQS)	Risk Weight		
	A	B	C

CQS 1	7%	12%	20%
CQS 2	8%	15%	25%
CQS 3	10%	18%	35%
CQS 4	12%	20%	35%
CQS 5	20%	35%	35%
CQS 6	35%	50%	50%
CQS 7	60%	75%	75%
CQS 8	100%	100%	100%
CQS 9	250%	250%	250%
CQS 10	425%	425%	425%
CQS 11	650%	650%	650%
Below CQS 11	1250%	1250%	1250%

12.12 Table: Positions with short term credit assessments

Credit Quality Step (CQS)	Risk weight		
	A	B	C
CQS 1	7%	12%	20%
CQS 2	12%	20%	35%
CQS 3	60%	75%	75%
All other credit assessments	1250%	1250%	1250%

12.13 Subject to paragraphs 12.16 and 12.17, the risk weights in column A of each table in 12.11 and 12.12 must be applied where the position is in the most senior tranche of a securitisation.

12.14 When determining under paragraph 12.7 whether a tranche is the most senior for these purposes, a firm need not take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

12.15 A firm may apply a risk weight of 6% to a position which is a position in the most senior tranche of a securitisation where that tranche is senior in all respects to another tranche of the securitisation positions which would receive a risk weight of 7% under paragraph 12.10 (see paragraph 12.16).

12.16 Paragraph 12.25 applies provided that it can be demonstrated that this is justified due to the loss absorption qualities of subordinate tranches in the securitisation; and either the position has an external credit assessment which has been determined to be associated with credit quality step 1 in 12.11 and 12.12 or, if it is unrated, requirements 12.7.1 to 12.7.3 are satisfied where

'reference positions' are taken to mean positions in the subordinate tranche which would receive a risk weight of 7% under paragraph 12.10.

12.17 The risk weights in column C of each table in 12.11 and 12.12 must be applied where the position is in a securitisation where the effective number of exposures securitised is less than six. In calculating the effective number of exposures securitised multiple exposures to one obligor must be treated as one exposure. The effective number of exposures is calculated in accordance with Schedule 9, paragraph 49 of the BCACI Regulations.

12.18 In the case of resecuritisation, the firm must look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem.

12.19 The risk weights in Column B in the tables 12.11 and 12.12 must be applied to all other positions.

The ABCP internal assessment approach

12.20 If:

12.20.1 a firm's IRB permission allows it to use this treatment, and

12.20.2 the conditions in paragraphs 12.21 to 12.35 are satisfied,

a firm may attribute to an unrated position in an asset backed commercial paper programme a derived rating as laid down in 12.22.

12.21 Positions in the commercial paper issued from the programme must be rated positions.

12.22 Under the ABCP internal assessment approach, the unrated position must be assigned by the firm to one of the rating grades described in paragraph 12.24. The position must be attributed a derived rating that is the same as the credit assessments corresponding to that rating grade as laid down in 12.24. Where this derived rating is, at the inception of the securitisation, at the level of investment grade or better, it must be treated in the same way as an eligible credit assessment by an eligible ECAI for the purposes of calculating risk-weighted exposure amounts.

Use test

12.23 The internal assessment methodology must be used in the firm's internal risk management processes, including its decision making, management information and capital allocation processes.

Mapping internal ratings to ECAI ratings

12.24 The firm's internal assessment methodology must include rating grades. There must be a correspondence between such rating grades and the credit assessments of eligible ECAIs. This correspondence must be explicitly documented.

ECAI methodology to be used

12.25 The firm must be able to satisfy the FSC that its internal assessment of the credit quality of the position reflects the publicly available assessment methodology of one or more eligible ECAIs, for the rating of securities backed by the exposures of the type securitised.

12.26 If a firm's IRB permission permits this, a firm need not comply with the requirement for the assessment methodology of the ECAI to be publicly available where it can demonstrate that due to the specific features of the securitisation – for example its unique structure - there is as yet no publicly available ECAI assessment methodology.

12.27 The ECAIs, the methodology of which must be reflected as required by 12.25, must include those ECAIs which have provided an external rating for the commercial paper issued from the programme. Quantitative elements – such as stress factors – used in assessing the position to a particular credit quality must be at least as conservative as those used in the relevant assessment methodology of the ECAIs in question.

12.28 In developing its internal assessment methodology the firm must take into consideration relevant published ratings methodologies of the eligible ECAIs that rate the commercial paper of the ABCP programme. This consideration must be documented by the firm and updated regularly, as outlined in 12.34.

Risk mitigants

12.29 The ABCP programme must have collections policies and processes that take into account the operational capability and credit quality of the servicer. The programme must mitigate seller/servicer risk through various methods, such as triggers based on current credit quality that would preclude co-mingling of funds.

12.30 The ABCP programme must incorporate structural features – for example wind down triggers - into the purchase of exposures in order to mitigate potential credit deterioration of the underlying portfolio.

Due diligence

12.31 The ABCP programme must incorporate underwriting standards in the form of credit and investment guidelines. In deciding on an asset purchase, the programme administrator must consider the type of asset being purchased, the type and monetary value of the exposures arising from the provision of liquidity facilities and credit enhancements, the loss distribution, and the legal and economic isolation of the transferred assets from the entity selling the assets. A credit analysis of the asset seller's risk profile must be performed and must include analysis of past and expected future financial performance, current market position, expected future competitiveness, leverage, cash flow, and interest coverage, and debt rating. In addition, a review of the seller's underwriting standards, servicing capabilities, and collection processes must be performed.

12.32 The ABCP programme's underwriting standards must establish minimum asset eligibility criteria that, in particular:

12.32.1 exclude the purchase of assets that are significantly past due or defaulted;

12.32.2 limit excess concentration to individual obligor or geographic area; and

12.32.3 limit the tenor of the assets to be purchased.

12.33 The aggregated estimate of loss on an asset pool that the ABCP programme is considering purchasing must take into account all sources of potential risk, such as credit risk and dilution risk. If the seller-provided credit enhancement is sized based on only credit-related losses, then a separate reserve must be established for dilution risk, if dilution risk is material for the particular exposure pool. In addition, in sizing the required enhancement level, the programme must review several years of historical information, including losses, delinquencies, dilutions, and the turnover rate of the receivables.

Ongoing review

12.34 Internal or external auditors, an ECAI, or the firm's internal credit review or risk management function must perform regular reviews of the internal assessment process and the quality of the internal assessments of the credit quality of the firm's exposures to an ABCP programme. If the firm's internal audit, credit review, or risk management functions perform the review, then these functions must be independent of the ABCP programme business line, as well as the customer relationship.

12.35 The firm must track the performance of its internal ratings over time to evaluate the performance of its internal assessment methodology and must make adjustments, as necessary, to that methodology when the performance of the exposures routinely diverges from that indicated by the internal ratings.

Supervisory formula method

12.36 Subject to any permission of the type described in paragraph 12.43, under the supervisory formula method, the risk weight for a securitisation position must be the greater of 7% or the risk weight to be applied in accordance with paragraph 53 of Schedule 9 of the BCACI Regulations.

12.37 Subject to any permission of the type described in paragraph 12.43, the risk weight to be applied to the exposure amount must be as set out in paragraph 53 of Schedule 9 of the BCACI Regulations.

Simplified inputs

12.38 Paragraph 53 of Schedule 9 of the BCACI Regulations applies here.

12.39 Where a securitisation of retail exposures has a sufficiently low value of N for the simplification in paragraph 53 of Schedule 9 of the BCACI Regulations to result in a material change in the capital charge as compared to the position if

the approach in paragraph 53 of Schedule 9 of the BCACI Regulations were not taken, a firm should discuss with the FSC the suitability of its use.

Liquidity Facilities

12.40 The provisions in paragraph 12.41 to paragraph 12.43 apply for the purposes of determining the exposure value of an unrated securitisation position in the form of certain types of liquidity facility.

Cash advance facilities

12.41 A conversion figure of 0% may be applied to the nominal amount of a liquidity facility that meets the conditions set out in paragraph 11.14.

Exceptional treatment for liquidity facilities where KIRB cannot be calculated

12.42 When it is not practical for the firm to calculate the risk-weighted exposure amounts for the securitised exposures as if they had not been securitised and the position does not qualify for the ABCP internal assessment approach, a firm may apply to the FSC for a variation of its IRB permission under which, on an exceptional basis, it may temporarily apply the method in 12.44 for the calculation of risk-weighted exposure amounts for an unrated securitisation position in the form of a liquidity facility that meets the conditions to be a liquidity facility set out in paragraph 11.14 or that falls within the terms of paragraph 12.41.

12.43 Under the method in this paragraph, the highest risk weight that would be applied under the standardised approach to any of the securitised exposures had they not been securitised may be applied to the securitisation position represented by the liquidity facility. To determine the exposure value of the position a conversion figure of 50% may be applied to the nominal amount of the liquidity facility if the facility has an original maturity of one year or less. If the liquidity facility complies with the conditions in paragraph 12.41 a conversion figure of 20% may be applied. In other cases a conversion factor of 100% must be applied.

13. Securitisations of revolving exposures with early amortisation provisions

13.1 Where there is a securitisation of revolving exposures subject to an early amortisation provision, the originator must calculate an additional risk-weighted exposure amount in accordance with this section, in respect of the likelihood that the levels of credit risk to which it is exposed may increase following the operation of the early amortisation provision. Accordingly this section sets out how an originator must calculate a risk-weighted exposure amount when it sells revolving exposures into a securitisation that contains an early amortisation provision.

Additional capital requirements for securitisations of revolving exposures with early amortisation provisions

13.2 A firm must calculate a risk-weighted exposure amount in respect of the sum of the originator's interest and the investors' interest.

13.3 For securitisation structures where the securitised exposures comprise revolving exposures and non-revolving exposures, an originator must apply the treatment set out in this section to that portion of the underlying pool containing revolving exposures.

13.4 For the purposes of this section, subject to paragraph 13.6:

13.4.1 originator's interest means the exposure value of that notional part of a pool of drawn amounts sold into a securitisation, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having securitisation positions in the securitisation;

13.4.2 to qualify as such, the originator's interest may not be subordinate to the investors' interest; and

13.4.3 investors' interest means the exposure value of the remaining notional part of the pool of drawn amounts.

13.5 Subject to paragraph 13.10, the exposure of the originator associated with its rights in respect of the originator's interest must not be treated as a securitisation position but as a pro rata exposure to the securitised exposures as if they had not been securitised.

13.6 For firms using the IRB approach, this paragraph applies in place of paragraph 13.4.

13.7 For the purposes of this section, originator's interest means the sum of:

13.7.1 the exposure value of that notional part of a pool of drawn amounts sold into a securitisation, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having securitisation positions in the securitisation; and

13.7.2 the exposure value of that part of the pool of undrawn amounts of the credit lines, the drawn amounts of which have been sold into the securitisation, the proportion of which to the total amount of such undrawn amounts is the same as the proportion of the exposure value described in 13.7.1 to the exposure value of the pool of drawn amounts sold into the securitisation.

13.8 To qualify as such the originator's interest may not be subordinate to the investors' interest.

13.9 Investors' interest means the exposure value of the notional part of the pool of drawn amounts not falling within 13.7.1 plus the exposure value of that part of the pool of undrawn amounts of credit lines, the drawn amounts of which have been sold into the securitisation, not falling within 13.7.2.

13.10 For firms using the IRB approach set out in the Guidance Note on the IRB Approach to credit risk, this paragraph applies in place of paragraph 13.5. The exposure of the originator associated with its rights in respect of that part of the originator's interest described in paragraph 13.7.1 must not be treated as a securitisation position but as a pro rata exposure to the securitised drawn amounts as if they had not been securitised in an amount equal to that described in paragraph 13.7.1. The originator must also be considered to have a pro rata exposure to the undrawn amounts of the credit lines, the drawn amounts of which have been sold into the securitisation, in an amount equal to that described in paragraph 13.7.2.

Exemptions from early amortisation treatment

13.11 Originators of the following types of securitisation are exempt from the capital requirement in paragraph 13.1:

13.11.1 securitisations of revolving exposures whereby investors remain fully exposed to all future draws by borrowers so that the risk on the underlying facilities does not return to the originator even after an early amortisation event has occurred; and

13.11.2 securitisations where any early amortisation provision is solely triggered by events not related to the performance of the securitised assets or the originator, such as material changes in tax laws or regulations.

Maximum capital requirement

13.12 For an originator subject to the requirement in paragraph 13.1 the total of the risk-weighted exposure amounts in respect of its positions in the investors' interest (as defined in paragraph 13.4 or 13.6 and 13.7) and the risk-weighted exposure amounts calculated under paragraph 13.1 must be no greater than the greater of:

13.12.1 the risk-weighted exposure amounts calculated in respect of its positions in the investors' interest (as so defined); and

13.12.2 the risk-weighted exposure amounts that would be calculated in respect of the securitised exposures by a firm holding the exposures as if they had not been securitised in an amount equal to the investors' interest (as so defined).

13.13 Deduction of net gains, if any, arising from the capitalisation of future income must be treated outside the maximum amount indicated in paragraph 13.12.

Calculation of risk-weighted exposure amounts

13.14 The risk-weighted exposure amount to be calculated in accordance with paragraph 13.1 must be determined by multiplying the amount of the investors' interest (as defined in paragraph 13.4 or paragraph 13.6 and 13.7) by the product of:

13.14.1 the appropriate conversion figure as indicated in table 13.19, paragraph 13.22 or 13.23; and

13.14.2 the weighted average risk weight that would apply to the securitised exposures if the exposures had not been securitised.

13.15 An early amortisation provision must be treated as controlled for the purposes of this section where the following conditions are met:

13.15.1 the originator has an appropriate capital/liquidity plan in place to ensure that it has sufficient capital and liquidity available in the event of an early amortisation;

13.15.2 throughout the duration of the transaction there is a pro rata sharing between the originator's interest and the investors' interest (as defined in paragraph 13.4 or 13.6 and 13.7) of payments of interest and principal, expenses, losses and recoveries based on the balance of receivables outstanding at one or more reference points during each month;

13.15.3 the amortisation period is considered sufficient for 90% of the total debt (originator's and investors' interest (as defined in paragraph 13.4 or paragraphs 13.6 and 13.7)) outstanding at the beginning of the early amortisation period to have been repaid or recognised as in default; and

13.15.4 the speed of repayment is no more rapid than would be achieved by straight-line amortisation over the period set out in 13.15.3.

13.16 In the case of a securitisation meeting the following conditions:

13.16.1 it is subject to an early amortisation provision;

13.16.2 the securitisation is of retail exposures which are uncommitted and unconditionally cancellable without prior notice; and

13.16.3 the early amortisation is triggered by the excess spread level falling to a specified level,

a firm must, to calculate the appropriate conversion figure referred to in paragraph 13.14, compare the three-month average excess spread level with the excess spread levels at which excess spread is required to be trapped.

13.17 In cases where the securitisation does not require excess spread to be trapped, the trapping point is deemed to be 4.5 percentage points greater than the excess spread level at which an early amortisation is triggered.

13.18 The conversion figure to be applied must be determined by the level of the actual three month average excess spread in accordance with table 13.19.

13.19 Table: Conversion factors:

	Securitisations subject to a controlled early amortisation provision	Securitisation subject to a non-controlled early amortisation provision
3 months average excess spread	Conversion factor	Conversion factor
Above level A	0%	0%
Level A	1%	5%
Level B	2%	15%
Level C	10%	50%
Level D	20%	100%
Level E	40%	100%

13.20 In the table above:

13.20.1 Level A means levels of excess spread less than 133.33% of the trapping level of excess spread but not less than 100% of that trapping level;

13.20.2 Level B means levels of excess spread less than 100% of the trapping level of excess spread but not less than 75% of that trapping level;

13.20.3 Level C means levels of excess spread less than 75% of the trapping level of excess spread but not less than 50% of that trapping level;

13.20.4 Level D means levels of excess spread less than 50% of the trapping level of excess spread but not less than 25% of that trapping level; and

13.20.5 Level E means levels of excess spread less than 25% of the trapping level of excess spread.

13.21 In the case of a securitisation meeting the conditions in this paragraph, a firm may apply to the FSC for a waiver that would allow a treatment which approximates closely to that prescribed in paragraph 13.16 to paragraph 13.20 for determining the conversion figure indicated. If a firm wants such a waiver, it should satisfy the FSC as to the following:

13.21.1 the securitisation is subject to an early amortisation provision

of retail exposures;

13.21.2 those retail exposures are uncommitted and unconditionally cancellable without prior notice;

13.21.3 the early amortisation is triggered by a quantitative value in respect of something other than the three month average excess spread;

13.21.4 the firm can establish a quantitative measure equivalent, in relation to the value in 13.22.3, to the trapping level of excess spread; and

13.21.5 that treatment is a prudent measure of the risk referred to in paragraph 13.1.

13.22 All other securitisations subject to a controlled early amortisation provision of revolving exposures are subject to a credit conversion figure of 90%.

13.23 All other securitisations subject to a non-controlled early amortisation provision of revolving exposures are subject to a credit conversion figure of 100%.

Liquidity plans

13.24 A firm which is an originator of a revolving securitisation transaction involving early amortisation provisions should have liquidity plans to address the implications of both scheduled and early amortisation.

Recognition of credit risk mitigation on securitisation positions

13.25 This section applies to credit risk mitigation in relation to a securitisation position.

13.26 Where credit protection is obtained on a securitisation position, the calculation of risk-weighted exposure amounts may be modified in accordance with Schedule 8 of the BCACI Regulations and, so far as applicable, the Guidance Note on the IRB Approach on credit risk.

Exposures to transferred credit risk

13.26A(1) "retention of net economic interest" means-

(a) retention of no less than 5% of the nominal value of each of the tranches sold or transferred to investors;

(b) in the case of securitisations of revolving exposures, retention of the originator's interest of no less than 5% of the nominal value of the securitised exposures;

(c) retention of randomly selected exposures, equivalent to no less than 5% of the nominal amount of the securitised exposures, where such exposures would otherwise have been securitised, provided that the number of potentially securitised exposures is no less than 100 at the commencement; or

(d) retention of the first loss tranche and, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total no less than 5% of the nominal value of the securitised exposures.

"ongoing basis" means that retained positions, interest or exposures are not hedged or sold.

(2) A credit institution (when not acting as an originator, a sponsor or original lender) shall be exposed to the credit risk of a securitisation position in its trading or non-trading book only if the originator, sponsor or original lender has explicitly disclosed to the credit institution that it will retain, on an ongoing basis, a material net economic interest of no less than 5%.

(3) For the purposes of (1), net economic interest-

(a) shall be measured at the commencement and shall be maintained on an ongoing basis;

(b) shall not be subject to any credit risk mitigation or any short positions or any other hedge; and

(c) shall be determined by the notional value for off-balance sheet items.

(4) There shall be no multiple applications of the retention requirements for any given securitisation.

(5) Where-

(a) a European parent credit institution or a European financial holding company, or one of its subsidiaries, is an originator or a sponsor;

(b) securitises exposures from several credit institutions, investment firms or other financial institutions which are included in a consolidated supervision may satisfy the requirement referred to in (2) to (4) on the basis of the consolidated situation of the related European parent credit institution or European financial holding company.

(6) Section (5) shall apply only where credit institutions, investment firms or financial institutions which created a securitised exposures have committed themselves to adhere to the requirements set out in sub-regulation (16) to (19) and deliver, in a timely manner, to the originator or sponsor and to a European parent credit institution or a European financial holding company the information needed to satisfy the requirements in sub-regulation (20) to (22).

(7) Section (2) shall not apply-

(a) where the securitised exposures are claims or contingent claims on or fully unconditionally and irrevocably guaranteed by-
  (i) central governments or central banks;
  (ii) regional governments, local authorities and public sector entities of EEA States;

(iii) institutions to which a 50% risk weight or less is assigned under regulations 28 to 33; or
(iv) multilateral development banks;

(b) transactions based on a clear, transparent and accessible index, where the underlying reference entities are identical to those that make up an index of entities which is widely traded, or are other tradable securities other than securitisation positions;

(c) syndicated loans, purchased receivables or credit default swaps where these instruments are not used to package or hedge (or both) a securitisation that is covered by (2) to (4).

(8) A credit institution shall demonstrate, before investing, and as appropriate thereafter, to the Commissioner for each of its individual securitisation positions, that it has a comprehensive and thorough understanding of and have implemented formal policies and procedures appropriate to their trading and non-trading book and commensurate with the risk profile of its investments in securitised positions for analysing and recording-

(a) information disclosed under (2) to (4) by originators or sponsors to specify the net economic interest that they maintain, on an ongoing basis, in the securitisation;
(b) the risk characteristics of the individual securitisation position;
(c) the risk characteristics of the exposures underlying the securitisation position;
(d) the reputation and loss experience in earlier securitisations of the originators or sponsors in the relevant exposure classes underlying the securitisation position;
(e) the statements and disclosures made by the originators or sponsors, or their agents or advisors, about their due diligence on the securitised exposures and, where applicable, on the quality of the collateral supporting the securitised exposures;
(f) where applicable, the methodologies and concepts on which the valuation of collateral supporting the securitised exposures is based and the policies adopted by the originator or sponsor to ensure the independence of the valuer; and
(g) all the structural features of the securitisation that can materially impact on the performance of the credit institution's securitisation position.

(9) A credit institution shall regularly perform its own stress tests appropriate to its securitisation positions and accordingly may rely on financial models developed by an external credit assessment institution if that credit institutions can demonstrate, when requested, that it took due care prior to investing to validate the relevant assumptions in and structuring of the models and to understand methodology, assumptions and results.

(10) A credit institution (when not acting as an originator or sponsor or original lender) shall establish formal procedures appropriate to its trading and non-trading book and commensurate with the risk profile of its investments in securitised positions, to monitor on an ongoing basis and in a timely manner, performance information on the exposures underlying its securitisation positions.

(11) Where relevant, procedures under sub-regulation (10) shall include the exposure type, the percentage of loans which are more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure, collateral type and occupancy, and frequency distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification, frequency distribution of loan to value ratios with bandwidths which facilitate adequate sensitivity analysis.

(12) Where the underlying exposures are themselves securitisation positions, a credit institutions shall have information not only on the underlying securitisation tranches, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying those securitisation tranches.

(13) A credit institutions shall have a thorough understanding of all structural features of a securitisation transaction which would materially impact the performance of its exposures to the transaction such as the contractual waterfall and waterfall related triggers, credit enhancements, liquidity enhancements, market value triggers, and deal-specific definition of default.

(14) Where the requirements in (8), (9), (15) and (20) to (22) are not met in any material respect by reason of the negligence or omission of a credit institution, the Commissioner shall impose a proportionate additional risk weight of no less than 250% of the risk weight (capped at 1250%) which would, but for this sub-regulation and (10) to (13) and (15), apply to the relevant securitisation positions under Part 4 of Schedule 9 and shall progressively increase the risk weight with each subsequent infringement of the due diligence provisions.

(15) The Commissioner shall take into account the exemptions for certain securitisations provided in sub-regulation (7) by reducing the risk weight he would otherwise impose under this regulation in respect of a securitisation to which that sub-regulation applies.

(16) A sponsor and an originator credit institution shall apply the same sound and well-defined criteria for credit-granting in accordance with the requirements of paragraph 3 of Schedule 5 to exposures to be securitised as they apply to exposures to be held on their book.

(17) The same processes for approving and, where relevant, amending, renewing and re-financing credits shall be applied by the originator and the sponsor credit institution.

(18) A credit institution shall also apply the same standards of analysis to participations or underwritings in securitisation issues purchased from third parties whether such participations or underwritings are to be held on its trading or non-trading book.

(19) Where the requirements referred to in (16) to (18) are not met, regulation 45(1) shall not be applied by an originator credit institution which shall not exclude the securitised exposures from the calculation of its capital requirements.

(20) A sponsor and an originator credit institution shall disclose to investors the level of their commitment under (2) to (4) to maintain a net economic interest in the securitisation.

(21) A sponsor and an originator credit institution shall ensure that prospective investors have readily available access to all materially relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitisation exposure and such information

as is necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures.

(22) For the purposes of (20) and (21), materially relevant data shall be determined as at the date of the securitisation and where appropriate due to the nature of the securitisation thereafter.

(23) Sections (2) to (22) shall apply to new securitisations issued on or after 1 January 2011 and shall, after 31 December 2014 apply to existing securitisations where new underlying exposures are added or substituted after that date.

(24) The Commissioner may suspend temporarily the requirements in (2) to (6) during periods of general market liquidity stress.

Funded protection

13.27 Eligible funded protection is limited to that which is eligible for the calculation of risk-weighted exposure amounts under the standardised approach set out in the guidance note and recognition is subject to compliance with the relevant minimum requirements as laid down under those provisions.

Unfunded protection

13.28 Eligible unfunded protection and unfunded protection providers are limited to those which are eligible under Schedule 8 of the BCACI Regulations and recognition is subject to compliance with the relevant minimum requirements laid down under those provisions.

Credit risk mitigation under the ratings based method

13.29 Where risk-weighted exposure amounts are calculated using the ratings based method, the exposure value and/or the risk-weighted exposure amount for a securitisation position in respect of which credit protection has been obtained may be modified in accordance with the provisions of the Schedule 8 of the BCACI Regulations as they apply for the calculation of risk-weighted exposure amounts under the standardised approach set out in the Guidance Note on Credit Risk Standardised Approach.

Credit risk mitigation under the supervisory formula method – full protection

13.30 Paragraphs 13.31 to 13.33 apply where risk-weighted exposure amounts are calculated using the supervisory formula method where there is full protection.

13.31 A firm must determine the effective risk weight of the position. It must do this by dividing the risk-weighted exposure amount of the position by the exposure value of the position and multiplying the result by 100.

13.32 In the case of funded credit protection, the risk-weighted exposure amount of the securitisation position must be calculated by multiplying the funded protection-adjusted exposure amount of the position (E*, as calculated under Schedule 8 of the BCACI Regulations for the calculation of risk-weighted

exposure amounts under the standardised approach set out in the Guidance Note on Credit Risk Standardised Approach taking the amount of the securitisation position to be E) by the effective risk weight.

13.33 In the case of unfunded credit protection, the risk-weighted exposure amount of the securitisation position must be calculated by multiplying GA (the amount of the protection adjusted for any currency mismatch and maturity mismatch in accordance with the provisions of Schedule 8 of the BCACI Regulations and, so far as applicable, Section 10 of the Guidance Note on the IRB Approach) by the risk weight of the protection provider; and adding this to the amount arrived at by multiplying the amount of the securitisation position minus GA by the effective risk weight.

Credit risk mitigation under the supervisory formula method - partial protection

13.34 Paragraphs 13.35 to paragraph 13.36 apply where risk-weighted exposure amounts are calculated using the supervisory formula method where there is partial protection.

13.35 If the credit risk mitigation covers the 'first loss' or losses on a proportional basis on the securitisation position, a firm may apply the provisions in paragraph 13.30 to paragraph 13.33.

13.36 In other cases the firm must treat the securitisation position as two or more positions with the uncovered portion being the position with the lower credit quality. For the purposes of calculating the risk-weighted exposure amount for this position, the provisions in paragraph 53 of Schedule 9 of the BCACI Regulations apply subject to the modifications that 'T' is adjusted to e* in the case of funded protection; and to T-g in the case of unfunded protection, where e* denotes the ratio of E* to the total notional amount of the underlying pool, where E* is the adjusted exposure amount of the securitisation position calculated in accordance with the provisions of Schedule 8 of the BCACI Regulations as they apply for the calculation of risk-weighted exposure amounts under the standardised approach set out in the Guidance Note on Credit Risk on Standardised Approach taking the amount of the securitisation position to be E; and g is the ratio of the nominal amount of credit protection (adjusted for any currency or maturity mismatch in accordance with the provisions of Schedule 8 of the BCACI Regulations) to the sum of the exposure amounts of the securitised exposures. In the case of unfunded credit protection the risk weight of the protection provider must be applied to that portion of the position not falling within the adjusted value of 'T'.

14. Reduction in risk-weighted exposure amounts

14.1 This section applies as follows:

14.1.1 Paragraphs 14.4 and 14.3 apply to both the standardised approach and the IRB approach; and

14.1.2 Paragraphs 14.4 and 14.7 apply to the IRB approach.

14.2 In respect of a securitisation position in respect of which a 1250% risk weight applies, a firm may, as an alternative to including the position in its calculation of risk-weighted exposure amounts, deduct from its capital resources the exposure value of the position. For these purposes, the calculation of the exposure value may reflect eligible funded protection in a manner consistent with section 13.

14.3 Where a firm applies paragraph 14.2, 12.5 times the amount deducted in accordance with that paragraph must, for the purposes of paragraph 11.5 and 12.8, be subtracted from the amount specified in whichever of those paragraphs applies as the maximum risk-weighted exposure amount to be calculated by a firm to which one of those paragraphs applies.

14.4 The risk-weighted exposure amount of a securitisation position to which a 1250% risk weight is applied may be reduced by 12.5 times the amount of any value adjustments made by the firm in respect of the securitised exposures.

14.5 To the extent that value adjustments are taken account of for the purposes of paragraph 14.4 they must not be taken account of for the purposes of the calculation indicated in the treatment of expected loss amounts as per the Guidance Note on the IRB Approach.

14.6 The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any value adjustments made by the firm in respect of the position.

14.7 For the purposes of paragraph 14.2 (as it applies to the IRB approach):

14.7.1 the exposure value of the position may be derived from the risk-weighted exposure amounts taking into account any reductions made in accordance with paragraph 14.4 to 14.6; and

14.7.2 where the supervisory formula method is used to calculate risk-weighted exposure amounts and L < KIRBR and [L+T] > KIRBR the position may be treated as two positions with L equal to KIRBR for the more senior of the positions.