EBA/CP/2019/08

31 July 2019

RESTRICTED

Consultation Paper

Draft Guidelines

on the determination of the weighted average maturity (WAM) of the contractual payments due under the tranche

Contents

1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 31 10 2019. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive summary

Regulation (EU) No 575/2013[1] as amended by Regulation (EU) 2017/2401[2] (the CRR hereafter) provides that institutions, for the purpose of calculating the risk weighted exposure amounts of their securitisation positions in accordance with the provisions set out in Part Three, Title II, Chapter 5 of the CRR, may measure the maturity of a tranche as either the weighted average maturity of the contractual payments due under the tranche or the final legal maturity of the tranche. It also mandates the EBA to monitor the range of practices in this area, with particular regard to the measurement of the maturity of a tranche as the weighted average maturity (WAM hereafter) of the contractual payments due under the tranche, and issue guidelines by 31 December 2019.

Therefore, the purpose of these guidelines is to provide guiding principles to be followed by institutions opting for the use of the WAM approach instead of the final legal maturity approach, for the specific purpose of calculating the risk weighted exposure amounts of a securitisation position under the methods that use the maturity of the tranche as a risk factor, namely the SEC-IRBA and the SEC-ERBA

To this end, these guidelines aim to ensure that the methodology applicable for the determination of the WAM for regulatory purposes is sufficiently harmonised in order to increase consistency and comparability in the own funds held by institutions. This methodology should also be clear, to avoid arbitrage and allow for its usage by less sophisticated institutions using SEC-ERBA; conservative, to maintain a sufficient level of prudence; and simple, to facilitate the supervision by competent authorities.

In the case of traditional securitisations, these guidelines set out that the contractual payments due under the tranche should be understood to mean the combination of 1) the contractual payments of the underlying exposures payable to the securitisation special purpose vehicle (SSPE) and 2) the contractual payments payable by the SSPE to the tranche holders. In order to calculate these payments, as specified in detail in these guidelines, institutions should use an asset model to calculate the contractual payments of the borrowers in relation to the underlying exposures, and a liability model, which uses the output of the asset model as one of the inputs to calculate the contractual payments payable by the SSPE to the tranche holders in the coming periods

In the case of synthetic securitisations, these guidelines set out that the contractual payments due under the tranche should be understood to mean (both in the perspective of the originator and in the perspective of the protection provider calculating the WAM) the contractual payments of premia payable by the originator to the protection provider; and, in the case of funded credit

[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

[2] Regulation of the European Parliament and the Council No 2401/2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

protection, they consult on whether the reimbursement of the collateral pledged and any interest or coupons to be collected by the protection providers from the collateral should be considered contractual payments or not. In the case of tranches that do not benefit from any protection under the credit protection agreement of the synthetic securitisation (i.e. those that are more junior than the most subordinated protected tranche of the synthetic securitisation), the maturity of a tranche should not be determined in accordance with Article 257(1)(a), as the losses assigned to these tranches are understood as not being covered by the contractual premia paid under the protection agreement. Following this interpretation, these guidelines contain provisions on the asset model applicable to the pool of securitised exposures in order to determine their outstanding balance throughout the life of the protection, and the corresponding size of the protected tranches, which is the base for the calculation of those premia that are contingent on that size.

Finally, these guidelines also set out the requirements on the data on the underlying pool of assets and on the securitisation transaction for the institutions to be able to calculate the WAM of a tranche; the use of third party data and model providers; and further requirements on the implementation and use of the WAM approach.

3. Background and rationale

Mandate

1. The new CRR framework for securitisation has introduced tranche maturity (M_T) as an additional parameter in the CRR formulae to calculate the capital requirement of securitisation positions. Institutions using the SEC-IRBA or the SEC-ERBA are now required to include this parameter when calculating the risk-weighted exposure amounts applicable to their securitisation positions.

2. According to Article 257 of the CRR, two alternative approaches may be applied when determining the maturity of a tranche: i) the weighted average maturity (WAM) of the contractual payments due under the tranche3 or, ii) the final legal maturity of the tranche4. In both cases, the tranche maturity is subject to a floor of 1 year and a cap of 5 years. The choice between the WAM approach and the final legal maturity approach is left at the full discretion of the institutions.

3. Article 257(4) of the CRR mandates the EBA to monitor the range of market practices in this area, with particular regard to the application of Article 257(1)(a) (i.e. the WAM of the contractual payments due under the tranche) and to issue guidelines to specify the rules that institutions should follow when measuring the tranche maturity using the WAM approach.

Overview of current market practices

4. In order to monitor market practices, the EBA developed a qualitative questionnaire which included i) a first part dedicated to the current practices to assess whether and how institutions currently calculate the maturity of their securitisation positions and ii) a second part dedicated to the implementation of the guidelines, with the purpose to understand how institutions will choose from the two options when measuring the maturity of securitisation positions

5. The questionnaire was sent to a number of industry associations and was used as a relevant input for the drafting of the present guidelines.

Use and definition of the WAM

[3] In accordance with the following formula: $\sum_t t \cdot CF_t / \sum_t CF_t$ where CF_t denotes all contractual payments (principal, interests) payable by the borrower during period t.

[4] In accordance with the following formula: $M_T = 1 + (M_L - 1) * 80\%$ where M_L is the final legal maturity of the tranche

6. Most market participants have already been calculating the WAM of securitisation positions and consider it as a key parameter for several purposes such as pricing and trading, return calculation, funding and risk analysis and hedging in respect of traditional securitisations. For these purposes, WAM is calculated based on conditional cash flow assumptions such as prepayment, delinquency, default and recovery.

7. All respondents also view that the WAM of the contractual payment due under the tranche is a combination of both contractual payments of the borrower in relation to the securitised loan agreement and the contractual payments payable by the SSPE. They use these two dimensions in their cash flow models to estimate the maturity of the tranche. However, there are some cases where the maturity of the tranche would be determined regardless of the performance of the underlying assets (e.g. exposures to warehouse facilities, exposures to ABCP conduits, 'controlled amortisation' tranches5).

Asset models (to derive periodical cash flows to the SSPE)

8. The type of data and models (external / internal) used by institutions to calculate the WAM usually depends on the position they are having in the securitisation :

   a. When acting as an originator, sponsor or servicer, institutions tend to use internal data and to apply their own cash flow model.

   b. When acting as investors, institutions tend to use existing industry standard external models6 with data from investor reports and data from the European Data Warehouse or, when available, directly provided by the originator or servicer.

9. Institutions also tend to use the same parameters to determine the asset side cash flows although their consideration might differ. In particular, all respondents take into account prepayments in their cash flow models but there is no standardised market practice regarding the definition of the prepayment rate. On the contrary, it is less common to take into account i) defaults and delinquencies for maturity calculation unless the assets are expected to suffer significant losses (e.g. high risk portfolios, non-performing portfolios) or have already defaulted and ii) the economic cycle forecast as most cash flow models are based on historical data observed through the cycle.

Liability models (to derive contractual payments by the SSPE)

10. Similar to the asset models, most respondents tend to use their own liability models to derive the maturity of the tranche when acting as originator. External data and models are more likely to be used when institutions act as investors especially when the data have not been provided by the arranger/ servicer.

[5] After a period in which only interest payments are made, payments of principal start in a predefined way.

[6] Such models include but are not limited to Bloomberg, Intex, Trepp, and Moody's Analytics.

11. The liability model always intends to mirror the key contractual features of the securitisation as described in the transaction documentation. In general, pre and post enforcement interest and principal priority of payments as well as performance based triggers that can alter the priority of payments are implemented in these models for the calculation of WAM

12. Contractual features such as clean-up calls and other optional redemption such as step-up calls are also often considered in the model. In particular, institutions often model the probability that the option is exercised at call date taking into account the economics and the reputation of the originator of not exercising the call.

Implementation of the WAM

13. Most institutions intend to apply the WAM whenever possible as the final legal maturity is viewed as less risk-sensitive and leading to estimations that are more conservative. The choice between the WAM and the legal maturity will be made taking into account i) the data availability, ii) the benefit in terms of risk weights of using the WAM versus the final legal maturity and iii) the cost of developing the internal model or using an external model (depending on the complexity of the rules and parameters).

14. Although institutions acknowledge that the differences between the two approaches might be reduced notably in certain cases after applying the regulatory cap of 5 years and the floor of 1 year, they consider that in other cases using the WAM or the final legal maturity can produce significantly different results depending on i) the maturity of assets (differences tend to be higher for medium term underlying assets), ii) the amortisation structure ("pass through" or "scheduled"), and iii) the jurisdiction (due to differences in the legal period of enforcement and recovery).

15. Institutions would like to implement the WAM for all their securitisation exposures. However, they also note that the WAM might be challenging to implement on revolving loans and for securitisation exposures for which the underlying structure and credit enhancement is based on the proceeds from the liquidation of the assets and not from the contractual payments (e.g. car rental, retail floor planning).

Rationale of the guidelines

16. The purpose of these guidelines is to provide fundamental guiding principles on the WAM approach to be followed by institutions opting for the use of the WAM approach instead of the final legal maturity approach, for the specific purpose of calculating the capital requirements of a securitisation position under the SEC-IRBA or the SEC-ERBA. As a result, while current market practices have constituted a major starting point for the drafting of these guidelines, some deviations from such market practices are proposed to ensure that the calculation of the regulatory WAM is comparable across EU institutions and is made in a sufficiently prudent manner.

17. In particular, the present guidelines have been developed with the following objectives in mind:

    a. Ensure comparability and simplicity of the WAM approach. Institutions currently calculate the weighted average maturity of a tranche in a very heterogeneous way and for various purposes. The main objective of these guidelines is to ensure that the methodology applicable for the determination of the WAM for regulatory purposes is sufficiently harmonised in order to increase consistency and comparability in the capital held by institutions. This methodology should also be clear, conservative and simple to avoid arbitrage, to maintain a sufficient level of prudence and to facilitate its supervision by competent authorities.

    b. Ensure usability of the WAM approach: The present guidelines were also developed with the view that the use of the WAM approach should remain possible for all eligible institutions. These include institutions acting as investors that might not have a sufficient and direct access to data on the securitised exposures, and less sophisticated institutions using the SEC-ERBA approach. As a result, the guidelines pay particular attention to the extent to which external data and third party providers of data and models could be allowed for the calculation of the regulatory WAM.

    c. Ensure reliability and predictability of the WAM approach: Although institutions are often using the same parameters to calculate the WAM for tranches of traditional securitisations, their calibration might differ significantly especially with regard to the treatment of prepayment assumptions, default scenarios and optional redemption mechanisms of the notes. As a result, the guidelines are proposing a prudent approach for the calculation of the regulatory WAM whereby only predictable and reliable parameters should be used in the WAM model.

18. These guidelines provide different methodologies in the case of traditional and synthetic securitisations for the purpose of calculating the WAM of a tranche.

19. In the case of traditional securitisations, the contractual payments due under the tranche are understood to mean the combination of 1) the contractual payments of the borrowers in relation to the underlying exposures payable to the SSPE and 2) the contractual payments payable by the SSPE to the tranche holders. Therefore, these guidelines are capturing both of these dimensions and, therefore, contain provisions i) on the asset models applicable to the pool of securitised exposures and ii) on the liability models.

20. In case of synthetic securitisations, the contractual payments due under the tranche are understood to mean the contractual payments of premia payable by the originator to the protection provider. *[In the case of funded credit protection, the contractual payments should additionally include the reimbursement of the collateral pledged and any interest or coupons collected by the protection providers from the collateral].* That applies both when

the originator and when the protections provider is the institution determining the WAM. Only the maturity of those tranches that do benefit from any protection under the credit protection agreement of the synthetic securitisation (i.e. including those that are more senior than the most subordinated protected tranche of the synthetic securitisation), should be determined in accordance with Article 257(1)(a). However, the maturity of those tranches that are more junior than the most subordinated protected tranche of the synthetic securitisation should be determined in accordance with Article 257(1)(b). as the losses assigned to these tranches are understood as not being covered by the contractual premia paid under the protection agreement. Consequently, the EBA guidelines contain provisions on the asset cash flow models applicable to the pool of securitised exposures in order to determine their outstanding balance throughout the life of the protection, and the corresponding size of the protected tranches, which is the base for the calculation of those premia that are contingent on the size of the protected tranche.

21. With regard to the use of data, being the servicer of the securitised exposures is the key feature in respect of being able to use internal data, as the servicer has full access to the information needed to calculate the WAM, which is a subset of the information it needs to service these exposures. When the institution calculating WAM is not the servicer of the securitised exposures, it has to resort to external data, which in most cases will be available in the transparency templates set out in the Securitisation Regulation7.

22. It should be noted that the tranche maturity M_T, and thus - if opted for - the WAM, is a factor for the calculation of the risk weighted exposure amounts under both the SEC IRBA as set out in Article 259 CRR and the SEC ERBA as set out in Article 263 CRR . In contrast to the requirements for rating systems and internal models approaches to equity used for IRB purposes, for the WAM approach the CRR does not include a requirement in terms of a specific prior approval by competent authorities before the results of such WAM models may be used in the calculation of own funds requirements for securitisation positions in accordance with the SEC-IRBA or SEC-ERBA.

23. The guidelines are structured around several topics. The key features of the WAM model calculation are included in sections 4.3 (Traditional securitisation -- Methodology for determining the contractual payments due under the tranche to the SSPE), 4.4 (Traditional securitisation -- Methodology for determining the contractual payments payable by the SSPE) and 4.5 (Synthetic securitisation - Methodology for determining the contractual payments due under the tranche)

[7] Regulation (EU) 2017/2402 laying down a framework for securitisation and creating a specific framework for STS securitisation.

4. Draft guidelines on the determination of the weighted average maturity of the tranche

EBA/CP/20XX/XX

08 July 2019

RESTRICTED

Draft Guidelines on the determination of the weighted average maturity of the tranche in accordance with point (a) of Article 257(1) of Regulation (EU) No 575/2013

1. Compliance and reporting obligations

1.1 Status of these guidelines

1. These guidelines are issued pursuant to Article 16 of Regulation (EU) No 1093/2014. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authority and financial institutions must make every effort to comply with the guidelines.

2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authority as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

1.2 Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authority must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by ([dd.mm.yyyy]). In the absence of any notification by this deadline, competent authority will be considered by the EBA to be noncompliant. Notifications should be sent by submitting the form available on the EBA website to compliance@eba.europa.eu with the reference 'EBA/GL/2019/XX'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authority. Any change in the status of compliance must also be reported to EBA.

4. Notifications will be published on the EBA website, in line with Article 16(3) of Regulation (EU) No 1093/2010.Subject matter, scope and definition

2. Subject matter, scope and definitions

Subject matter

5. These guidelines specify the methodology for measuring the maturity of a tranche (M_T) as the weighted average maturity (WAM) of the contractual payments due under the tranche (CFt) referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013[8].

Scope of application

6. These guidelines fulfil the EBA's mandate to issue guidelines in accordance with Article 257(4) of Regulation (EU) No 575/2013.

7. These guidelines apply to institutions measuring the tranche maturity in accordance with point (a) of Article 257(1) of Regulation (EU) No 575/2013.

Addressees

8. These guidelines are addressed to competent authorities as defined in point i) of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation (EU) No 1093/2010.

Definitions

9. Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013 and in Regulation (EU) 2017/2402[9] have the same meaning in the guidelines.

[8]Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms; OJ L 176, 27.6.2013, p. 1.

[9] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitization; OJ L 347, 28.12.2017, p. 35.

3. Implementation

3.1 Date of Application

10. These guidelines apply from [dd.mm.yyyy]

4. Draft Guidelines

4.1 Contractual payments due under the tranche

4.1.1 For traditional securitisations

11. In the case of traditional securitisations, institutions should determine the contractual payments due under the tranche (CFt) by taking into account contractual payments in relation to the underlying exposures payable to the SSPE and those payable by the SSPE to the tranche holders as follows: Institutions should determine the contractual payments of the borrowers in relation to the underlying exposures payable to the SSPE in application of the asset model as set out in Section 4.3. The output of the application of the asset model should feed into the calculation of the contractual payments payable by the SSPE to the tranche holders in accordance with the priority of payments established in the transaction documentation and in application of the liability model as set out in Section 4.4.

4.1.2 For synthetic securitisations

12. In the case of synthetic securitisations, institutions should regard the contractual payments due under a tranche (CFt) as the contractual payments payable by the originator to providers of the credit protection by virtue of which the credit risk is transferred and if the following conditions are met:

    a. Where the credit protection, by virtue of which the risk is transferred in relation to positions in a tranche, fulfils the requirements as set out in Article 249 of Regulation (EU) No 575/2013, institutions should regard the contractual payments due under the tranche (CFt) as the contractual payments of premia payable by the originator institution to the protection provider of those tranches. [*In the case of funded credit protection, the contractual payments should additionally include the reimbursement of the collateral pledged and any interest or coupons collected by the protection providers from the collateral.]* This sub-paragraph applies both to the originator and to the protection provider.

    b. [*In the case of funded credit protection and in order to calculate the interest or coupons collected from the collateral pledge, where the contract already envisages that the payments applicable in future periods change according to a completely predetermined manner so that the exact value of the payment applicable in a future period can already be determined at the respective WAM calculation date, institutions should take those future contractual terms into account. Where the payments between the parties of the contract are linked to outstanding notional values that can be calculated in accordance with the provisions of the asset model*

set out in section 4.3, future payments should be adjusted to reflect the expected evolution of those notional values.]

c. Where the originator institution also holds tranches that are more senior than a tranche as set out in point a) , the originator institution should regard the contractual payments due under a tranche (CFt) of the former as the sum of the contractual payments of premia payable by the originator institution to the protection providers of all protected tranches that are subordinated to the tranche in question.

Explanatory text for consultation purposes

Although the weighted average life (WAL) of the securitised exposures is the current market practice for the calculation of the maturity of a tranche in synthetic securitisations, it has not been considered in the guidelines for regulatory purposes because of the difficulties to fit it due to the wording of article 257 of the CRR

Due to the nature of synthetic securitisations where the risk is transferred by a credit protection agreement, which not only has an effect on the tranche to which the positions subject to that agreement are associated, but also to more senior tranches, the calculation of the WAM for the more senior tranches should take into account that effect.

Question 1: Do you agree that the contractual payments due under the contract that provides credit protection by virtue of which the credit risk is transferred, and not those contractual payments of the borrowers in relation to the underlying exposures, are the ones to be considered for determining the WAM of a tranche in a synthetic securitisation from a regulatory perspective? If not, please provide evidence supporting your views.

Explanatory text for consultation purposes

In the case of funded credit protection, there might be different views on whether the reimbursement of the collateral pledged and any interest or coupons collected by the protection providers from the collateral should be considered contractual payments of the protected tranches or not, as they are linked to mitigating the counterparty credit risk of the protection provider rather than to compensating for the credit risk assumed under the contract.

Relevant considerations around taking into account the cash flows of the collateral in the case of funded credit protection are the following:

- It aligns the treatment of funded credit protection in synthetic securitisation with the treatment of traditional securitisations, in which the cash-flows coming from the amortisation of the tranches and the interest paid to the tranche holders (the reimbursement of collateral, and the interest or coupons it yields, would be considered equivalent in the case of funded credit protection) are taken into account in the calculation of the WAM.

- It may hinder the consistency of the treatment of synthetic securitisations in the guidelines as it deviates from the calculation of WAM for unfunded credit protection. This could be an specially problematic when funded and unfunded credit protection coexist in a synthetic securitisation (e.g. those synthetic transactions in which a multilateral development bank may provide unfunded protection for an upper mezzanine tranche and an institutional investor or a hedge fund may provide funded credit protection for the lower mezzanine tranche or the first loss piece), as the protected tranches of the securitisation would calculate WAM under different methodologies.

- According to the impact assessment, it results in a more conservative estimation of WAM than when computing the premia only. The WAM would be generally higher than the WAL of the securitised exposures, which is the current market practice, under a pro-rata amortisation, and would be close to the final legal maturity under a sequential amortisation.

- It increases the complexity of the modelling in the guidelines as it would require in addition the modelling of the interest and coupons that the collateral yields until the end of the contract.

Question 2: Do you agree that, in the case of funded credit protection, the reimbursement of the collateral pledged, and any interest or coupons collected by the protection providers from the collateral, should be considered contractual payments due under the tranche along with the premia, as referred to between brackets, and highlighted in italic, in paragraph 20 of the Rationale; paragraphs 12, 57 and 64 of the draft guidelines; and paragraphs 7, 13 and 14 of the impact assessment? If not, please provide evidence supporting your views.

4.2 Data and information requirements

4.2.1 Source of data on the underlying pool of exposures

Use of internal data

13. Where the institution is the servicer of the securitised exposures, it should use internal data on the underlying portfolio of securitised exposures to measure the WAM.

Use of external data

14. Where the institution is not the servicer of the securitised exposures and does not have access to internal data, it should only use the following sources of external data:

    a. data provided by the servicer, either directly or transmitted through a third party data provider.

    b. data on the underlying exposures of the securitisation made available by the originator, sponsor and SSPE in accordance with points (a) and (e) of Article 7(1) of Regulation (EU) 2017/2402 on securitisation[10] as further specified in Commission Delegated Regulation (xxx) on the information and the details of a securitisation to be made available by the originator, sponsor and SSPE. (insert referencefootnote to OJ number)

    c. data on the underlying exposures of the securitisation as required by Article 5 of Regulation (EU) 2017/2402 and made available by the originator, sponsor or SSPE in accordance with Article 7 of Regulation (EU) 2017/2402.

4.2.2 Required data on the underlying pool of exposures

15. In order to apply point (a) of Article 257(1) of Regulation (EU) No 575/2013 the data for the application of the asset model as set out in section 4.3 should be complete.

16. Where data necessary to apply the asset model is incomplete, the institution may make the necessary adjustments as set out in this section, unless the data concerns the current interest rate, the current principal balance or the currency denomination of the underlying exposures.

17. The adjustment should reflect the most conservative assumption, which should be the one that postpones the contractual payments closest to the final legal maturity of the

[10] Regulation (EU) 2017/2402 laying down a framework for securitisation and creating a specific framework for STS securitisation

transaction. In particular, the institution should apply the following non-exhaustive list of adjustments. Where information is incomplete in relation to:

a. the 'maturity date' institutions should apply the final legal maturity;

b. the 'amortisation type' institutions should apply bullet amortisation, meaning the amortisation in which the full principal amount is repaid in the last instalment;

c. the 'scheduled principal payment frequency', institutions should apply an annual frequency where the amortisation type requires periodical instalments;

d. 'scheduled interest payment frequency', institutions should apply an annual frequency where the amortisation type requires periodical instalments

18. By way of derogation from paragraph 16, where there is no information available on the 'current interest rate' of some exposures, and their outstanding amount does not exceed 5% of the total outstanding amount of the securitised exposures, the institution may apply on those exposures the exposure weighted average interest rate of the rest of the securitised exposures for which that information is available.

4.2.3 Required information on the securitisation transaction

19. The documentation of the transaction should be the primary source of information to calculate the contractual payments due by the SSPE to the holders of a securitisation position in a traditional securitisation, and to calculate the contractual payments derived from the protection agreement between the protection buyer and the protection provider in a synthetic securitisation.

20. Institutions should in particular use the information made available in accordance with Article 7 of Regulation (EU) 2017/2402, as further specified in the Commission Delegated Regulation (insert number) to determine the WAM of a tranche.

21. In the case of non-ABCP STS securitisations, institutions may also use the liability cash flow model made available in accordance with Article 22(3) of Regulation (EU) 2017/2402 as additional information for calculating the WAM of a tranche.

22. Where the originator, sponsor and SSPE are established in a third country, information made available on the documentation of the securitisation as required by Article 5 of Regulation (EU) 2017/2402 in accordance with Article 7 of Regulation (EU) 2017/2402.

4.2.4 Use of external data providers

23. Institutions should only rely on third party data providers if they have carried out appropriate due diligence to ensure the compliance of the third party with these guidelines.

4.3 Methodology for determining the contractual payments due to the SSPE (asset model)

4.3.1 General requirements for asset models

24. The asset model should reflect the contractual payments generated from the portfolio to the SSPE and should use as key parameters all relevant information that may affect those payments, including the principal, interest and, as applicable, fees.

25. The asset model should represent the payments on a loan-by-loan basis. Where asset types are very granular, such as trade receivables, the forecast may be modelled on the basis of homogenous sub-pools of the securitised exposures.

26. Cash flows coming from non-performing exposures should be modelled separately from those of performing exposures.

4.3.2 Methodology for performing underlying exposures

Payments of principal and interest

27. Loan level principal payments should be calculated in line with the terms agreed in the contract between the borrower and the originator or original lender, in particular in line with the contractual frequency of the payments and the expected amount of principal repayment amount and related interest charges that should be collected for each period.

Explanatory text for consultation purposes

According to market practice, the amortisation schedule usually consists of one of the following methods:

a. Constant principal: a constant amount of principal is repaid in each instalment. [In practice, the loan amount is divided by the number of instalments in order to determine the principal payment due on each loan payment date.]
b. Actuarial amortisation (constant instalment): the principal due on each instalment is calculated according to a formula that ensures that the instalment paid by the borrower (comprising a principal and an interest component) is constant over time.
c. Floating maturity loans: these are floating rate loans whose instalments (comprising an interest and a principal component) are calculated according to the actuarial amortisation formula but which are capped at a certain amount.
d. Increasing instalment amortisation: consists of an alteration of the actuarial amortisation formula which has the effect of producing increasing instalments (assuming stable interest rates).

e. Loans with flexible maturities: under certain conditions (e.g. no past arrears on the loan) the borrower has the option of changing the maturity of the loan.
f. Interest only or bullet amortisation: the full amount of the loan is repaid at maturity and during the life of the loan the borrower will pay only interest.
g. Microbullets amortisation: the borrower has the option to choose when to repay the loan's principal according to a certain flexible schedule (e.g. 5% of the principal must be repaid every two years, with no specification of the payment dates).

In some loan contracts, borrowers have the option to switch from one amortisation type to another or, more commonly, combine the repayment features described above (e.g. a loan that is half constant instalment and half bullet).

Regarding interest, there are fixed rated loans, adjustable rate loans, variable/floating rate loans or a combination. Floating rate loans' margin can change over time due to the terms of the loan agreement or to the expected increase/decrease of the reference rate.

Loan contracts may also consider various optionalities such as the presence of loans that start fixed and then switch to floating or vice versa and interest rate caps and floors.

28. Institutions should assume that the amortisation method and interest rates applicable on the respective WAM calculation date remain constant throughout the life of the loan where the contract foresees optionalities not yet realised or triggered. Where the contract already envisages that the amortisation method and/or interest rates applicable in future periods change according to a completely predetermined manner so that the exact value of the amortisation and/or interest rate applicable in a future period can already be determined at the respective WAM calculation date, institutions should take those future contractual terms into account.

Explanatory text for consultation purposes

Given the variety and complexity of the amortisation methods and interest rate options that might be considered in the contracts of the securitised exposures, institutions should assume that the amortisation method and interest rates applicable on each calculation date remain constant throughout the life of the loan for the purpose of calculating WAM.

Treatment of revolving periods

29. In order to determine the WAM of a tranche for revolving securitisations as defined in point (16) of Article 2 of Regulation (EU) 2017/2402, the remaining length of the revolving period at the respective WAM calculation date should be added in full to the weighted average

maturity of the tranche at such WAM calculation date as determined without consideration of the revolving period.

Assumptions in relation to prepayments

30. In relation to the performing portfolio at the respective WAM calculation date, zero future prepayments should be assumed.

Explanatory text for consultation purposes

Prepayments. According to market practice:

To account for the potential variability in prepayment speeds, models usually take into account both high-speed and low-speed prepayment scenarios, which depend on the jurisdiction and the asset type of the securitised exposures:

i) a high-speed prepayment scenario, reflects future periods of low interest rates and high refinancing activity, and it is intended to be reflective of historically observed long-term high prepayment rates

ii) whilst a low-speed prepayment scenario reflects a rising interest rate environment with low refinancing activity, which is intended to be reflective of the historically observed long-term low prepayment rates.

However, the prepayment assumptions may be adjusted to that of the original lender's prepayment experience when it differs significantly from the benchmark in the relevant jurisdiction. Deviations are also possible where the specific products offered by a lender have a higher prepayment propensity.

Models may also take into consideration an initial period immediately after origination for unseasoned transactions in which the propensity to prepay is low, due in part to incentive rates or prepayment penalties. For seasoned pools, prepayment rates of the closest periods are usually adjusted by the portfolio's most recent cumulative prepayment rate.

The prepayment rate is applied to the performing balance of the securitised portfolio (i.e. exclusive of defaulted and delinquent loans) before any scheduled principal payment.

Explanatory text for consultation purposes

Given the assumptions to be made in order to reflect future prepayment scenarios, which depend on the future levels of interest rates, refinancing activity and borrowers behaviour in presence of incentives or penalties, the adjustments to be made depending on the original lender's prepayment experience and the specific terms of the loan products, and in order to avoid undesirable complexity and variability in the results of the calculation of WAM by different institutions that might be exposed to the same securitisation tranche, zero prepayments should be assumed on the performing portfolio for calculating the WAM of a tranche

Question 3: Do you agree that zero prepayments should be assumed on the performing portfolio for calculating the WAM of a tranche? Do you think that such assumption has a significant impact on the calculation of risk-weighted exposure amounts for certain asset classes or for certain tranches, depending also on their seniority? If so, please provide evidence supporting your views.

Assumptions in relation to future defaults

31. In relation to the performing portfolio at the respective WAM calculation date, zero future defaults and delinquencies should be assumed.

Explanatory text for consultation purposes

Defaults- According to market practice:

Defaulted and delinquent borrowers are understood as as those who stop payment to the lender from a certain point in time onwards. For delinquent borrowers, this will be limited to a certain period of time , at the end of which the delinquent borrowers will restart paying their loans again. Loans in arrears are usually restructured, allowing the borrower to repay the amount in arrears in addition to ongoing scheduled payments over a limited period of time. The length of such arrangements depends on the individual lender's collection and servicing guidelines and on the financial means of the borrower.

It is usually assumed that a share of the monthly defaulting loan balance falls delinquent for a certain period. Thereafter, the delinquent balance becomes fully performing again and the accrued arrears interest is assumed to be fully repaid after a certain number of months]. In economic recessions, a greater proportion of financially distressed borrowers will ultimately default.

There are usually liquidation-timing curves for each delinquency bucket by sector (30-day, 60-day, 90-day, foreclosure and Real Estate Owned (REO)). These curves apply only to delinquent exposures that default and liquidate, while exposures that cure are not included, and try to capture frontloaded, midloaded and backloaded stress assumptions.

For the purposes of cash flow modelling, jurisdiction-specific and asset-type-specific assumptions on unpaid principal due to arrears or defaults are made. At issuance, the historical average default rate of the asset type is usually used. In the case of seasoned transactions, the observed defaults in the last year in the securitised portfolio are usually taken into account for the next period after which it is usually assumed that defaults will migrate back toward the historical benchmark values.

Explanatory text for consultation purposes

Given the assumptions to be made in order to reflect future default and delinquency scenarios, which may differ from one institution to another, zero defaults and delinquencies of the underlying portfolio should be assumed on the performing portfolio for the purpose of WAM calculation.

Question 4: Do you agree that zero defaults should be assumed on the performing portfolio for calculating the WAM of a tranche? Do you think that such assumption has a significant impact on the calculation of risk-weighted exposure amounts for certain asset classes or for certain tranches, depending also on their seniority? If so, please provide evidence supporting your views.

Cash account and other investments

32. The asset model should take into account any income coming from the deposit account and other short-term investments made by the SSPE. Institutions should assume that the interest rates applicable on the respective WAM calculation date remain constant throughout the life of the investment where the contract foresees optionalities not yet realised or triggered. Where the contract already envisages that the interest rates applicable in future periods change according to a completely predetermined manner so that the exact value of the interest rate applicable in a future period can already be determined at the respective WAM calculation date, institutions should take those future contractual terms into account.

Contractual agreements on the securitised exposures

33. The asset model should take into account any contractual agreement entered into by the issuer, designed to mitigate the risk of the securitised exposures. At each WAM calculation date, payments between the parties of the contract should be assumed constant at the current level for the remaining life of the contract even if the contract foresees optionalities not yet realised or triggered.

34. Where the contract already envisages that the payments applicable in future periods change according to a completely predetermined manner so that the exact value of the payment applicable in a future period can already be determined at the respective WAM calculation date, institutions should take those future contractual terms into account.

35. Where the payments between the parties of the contract are linked to outstanding notional values, which can be calculated in accordance with the provisions of the asset model set out in this section, future payments should be adjusted to reflect the expected evolution of those notional values.

Contractually agreed triggers on the securitised exposures

36. The asset model should consider contractually agreed triggers that change the cash flow of the securitised exposures from that time and onwards where the respective trigger event has occurred.

4.3.3 Methodology for non-performing exposures

37. In the case of existing non-performing exposures at the time of the calculation of the WAM, the principal and interest payments in respect of such exposures throughout the life of the securitisation should be assumed zero, and the asset model should assume that none of such exposures will cure in the future.

Question 5: Do you consider the assumption that, in the case of the existing non-performing exposures at the time of the calculation of WAM, the principal and interest payments in respect of such exposures throughout the life of the securitisation should be assumed zero, and the asset model should also assume that no exposure will cure in the future, reasonable? If not, would the added complexity introduced by a differentiated modelling of payments received on non-performing exposures be justified in terms of the impact on risk-weighted exposure amounts? If so, could you provide evidence supporting your views? [Please substantiate your views.]

Recovery rate assumptions

38. Where the SEC-IRBA is applied to the respective tranche for which WAM is being calculated, for all securitised exposures in respect of which the institution is able to calculate Kirb in accordance with Part Three, Title II, Chapter 5, Section 3 of Regulation (EU) No 575/2013, the institution should use 1 minus the LGD as applied in the calculation of K_{IRB} as the recovery rate. Where the SEC-ERBA is applied to a tranche, and the institution is able to determine the LGD in accordance with the requirements of Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013 of part of the securitised exposures, the institution should use 1 minus such LGD as the recovery rate of these securitised exposures.

39. Where securitised exposures other than those referred to in paragraph 38 are concerned, institutions should use 1 minus the average historical loss rate observed during the last 5 years for the asset class and jurisdiction as the recovery rate. Where that information is not available, the highest historical observed loss rate should be used instead. Where none of this information is available from reliable sources, such as mortgage associations in the case of mortgage loans or credit rating agencies with long data records, institutions should use a 50% loss rate for senior non-retail securitised exposures and for retail securitised exposures and a 100% loss rate for non-senior non-retail securitised exposures.

Explanatory text for consultation purposes

Recovery rates. According to market practice:

Models usually generate rating-specific foreclosure frequencies, loss severities and recovery rates for each loan in the portfolio.

Assumptions on recovery rates may be capped in specific jurisdictions depending on the local legal regime, common market practice, or the country's economic environment, as well as historic market-wide and originator-specific recovery rate performance information.

As the borrowers repay their loans' principal, the loan-to-value ratios (LTVs) of the loans decrease over time and the recovery rate will progressively increase as a result of the "deleveraging" of the loans. Models take this deleveraging effect into account, but cap the increase of the recovery rates applied over time by the cash flow model to the minimum of:

a) the historical recovery rates achieved by the originator and its peers on similar assets; and
b) maximum recovery expectations in stressed environments, considering the characteristics of the assets and of the jurisdiction.

Usually, the base case scenario relies on the prior two-year historical average recovery rate but excludes any observations of voluntary prepayments from any exposure in delinquent status other than current as well as any observations of liquidations from loans in any status other than 90 days + delinquencies, foreclosure or real estate owned (REO) assets. When applying stressed assumptions, it lengthens the amount of time that the loans stay in their delinquency buckets, decreasing the total amount of cash available for payment of interest and principal.

Recovery timing assumptions

40. The recovery timing should be assumed to be the average historical workout period observed in the last 5 years in the same asset class and jurisdiction. Where that information is not available, the longest historical observed workout period should be used instead. Where none of this information is available from reliable sources (e.g. national mortgage associations in the case of mortgage loans or credit rating agencies with long data records) institutions should consider that all the recoveries will take place at the final legal maturity of the transaction.

Explanatory text for consultation purposes

Timing of the recoveries

According to market practice:

Models estimate the timing and amount of pool liquidations, the amount of payments from delinquent loans that cure and the percentage of delinquent loans in each period.

Sometimes the models assume that defaults and liquidations occur simultaneously. This is to account for the fact that losses are observed at the point of liquidation due to servicer advancing or other available mechanisms that provide liquidity to the transaction and allow for timely payment of interest and principal on the notes. Servicer advancing covers principal and interest payments on delinquent mortgages through liquidation, to the extent those advances are deemed recoverable. In all other cases the timing of recoveries has to be also estimated.

Usually, the model benchmarks the base-case transition assumptions to industry average delinquency transition rates (i.e. roll rates) observed over a certain period. In a stress scenario analysis, the model considers increasing slower transition rates to the liquidation process, resulting in delayed recovery timing assumptions. The transition rates are applied to loans based on their delinquency status and distinguish between loans in judicial and non-judicial foreclosure states to reflect the differences in liquidation timelines by region. The transition rates generate the cash flow vectors (timing and amount of liquidations, prepayments and delinquencies).

Depending on the jurisdiction, sources of recovery such as attachment of the borrower's salary might be taken into account, as long as the issuer has full and unencumbered access to them.

In the case of RMBS the assumed length of the foreclosure period is based on the empirical evidence available in each jurisdiction, and depends in good part on the regulatory framework governing the foreclosure process.

4.4 Traditional Securitisations. Methodology for determining the contractual payments payable by the SSPE to the noteholders (liability model)

4.4.1 General principles of the liability model

41. All the input variables introduced regarding the liability model for the calculation of the WAM, as set out in Section 4.4., should accurately reflect the contractual terms and conditions of the transaction as defined in the securitisation transaction documentation, including but not limited to:

a. all relevant information on the tranches such as the final legal maturity, the payment frequency, the coupon rate, the interests, principal and notional amounts of the tranches;

b. the key structural features such as the priority of payments (and related triggers), fees and the structural protection mechanisms.

42. Optional contractual features except clean-up calls as referred to in point (g) of Article 244(4) of Regulation (EU) No 575/2013 that would reduce the maturity of the tranche should not be considered.

4.4.2 Determination of the total amount payable by the SSPE

General principles for determining the total cash flow amount

43. Institutions should accurately calculate the total cash flow amount payable by the SSPE at each payment date.

44. That amount should take into account the collection of interests, fees and principal payments from the securitised exposures as calculated in application of the asset model as set out in Section 4.3 . Institution should then adjust that outcome to account for any cash flows coming from hedging arrangements and structural protection mechanisms in line with the transaction documentation, where applicable, before allocating the contractual payments to the tranches as set out in this Section.

Adjustments

45. Hedging arrangements entered into by the SSPE to cover for payment mismatches between the cash flows generated by the underlying exposures and the cash flows payable to the liabilities should be taken into account in the calculation of the total available cash flow amount payable by the SSPE. These adjustments should in particular include the outflows and inflows coming from currency and interest rate swaps, where applicable.

46. Institutions should also include the actual cash flows derived from the use of structural protection mechanisms aiming at ensuring that the principal and interest payable on the tranches are paid fully and timely, where applicable, such as the outflows or inflows resulting from a liquidity facility, a reserve fund or an excess spread trapping mechanism.

47. Institutions should include these adjustments only where a hedging arrangement or a structural protection mechanism has been used and has an impact on the total payable amount. Institutions should rely on actual observed data as applicable at the date of calculation of the WAM.

4.4.3 Allocation of the contractual payments among the tranche holders

48. The allocation of payments among tranche holders should appropriately reflect the terms of the contractual agreement of the securitisation transaction as applicable at the date of calculation of the WAM.

Treatment of structural features

49. All the structural features of the transaction that govern the allocation of payment among the tranche holders should be taken into account when modelling the liability cash flows. These should include, in particular, the contractual rules regarding the priority of payments, the amortisation profile of the notes and any changes following the use of a trigger.

Priority of payment

50. The allocation of payments to each tranche holder should follow the contractual rules regarding the priority of payment, which specify the order in which the notes of each tranche are paid and the timing under which the payments are allocated.

Explanatory text for consultation purposes

According to market practice, typically, costs and fees such as structuring fees, underwriting fees, legal costs, rating fees, servicer fees and net payments to hedging counterparties are served first before cash flows are being allocated to tranches according to the priority of payment as defined in the transaction documentation.

The priority of payments can be arranged in a number of ways that would have different impacts on the allocation of the payments. For example, in the case of combined waterfall structures, principal, interests and, where applicable, fees collected from the exposures should be merged and distributed according to one single priority of payment. Principal payments to each note should be assumed to be subordinated to the payment of interest on the notes. In the case of separate waterfall structures, the principal, interests and, where applicable, fees collected from the exposures should be kept separately and distributed according to a separate principal waterfall and interest waterfall, respectively.

The amortisation of the principal of the notes can take numerous ways, such as sequential /pro-rata amortisation, pass-through / controlled amortisation, and turbo amortisation.

51. The liability model should reflect accurately the priority of payments at the time of the calculation of the WAM.

52. In addition, where applicable, the prevailing rules regarding the replenishment of the liquidity facility after a partial or full draw down, the amortisation of the reserve fund, and the replenishment of the principal deficiency ledger should be taken into account when determining the payment of each note.

Amortisation profile

53. The amortisation of the notes of a tranche should be factored into the liability model. In particular, the liability model should accurately replicate the amortisation rules applicable to each note as defined in the priority of payments according to the transaction documentation at the time of the calculation of the WAM.

Triggers

54. The contractual triggers modifying the cash flows of the transaction should be considered in the liability model only at the time when they have been activated at the date of calculation of the WAM. Triggers based on the performance of the underlying assets, such as delinquency and loss rates or on the prepayment speed of the underlying assets should not be assumed active unless the actual performance as of calculation date meet the pre-determined conditions.

Explanatory text for consultation purposes

Triggers. According to market practice:

In the most common cases, they are used to:

- Change the priority of payments so that the principal redemption of senior notes rank higher than the interest payments to subordinated notes;
- Change a pro rata principal payment to a sequential payment;
- Defer the interest on junior notes to allow for a faster redemption of senior notes accelerate
- Accelerate the full payment of senior or junior notes.

Those triggers could be quantitative or qualitative and may refer to a rating downgrade of the servicer (or another counterparties) or the restructuring of the notes/ transactions.

Treatment of optional features

55. Optional contractual features, such as step-up calls, put options, regulatory and tax calls that would reduce the maturity of the note should not be considered.

56. By way of derogation from the previous paragraph, clean-up calls in accordance with point (g) of Article 244(4) of Regulation (EU) No 575/2013 that permit early redemption of the notes before the securitised exposures are fully amortised, may be taken into account.

Explanatory text for consultation purposes

In order to be aligned with the provisions of Chapter 5 of CRR related with significant risk transfer, that determine the application of the securitisation capital requirements for originator's positions, clean up calls that fulfil the conditions of Article 245(4)(f) of the CRR should be allowed to be taken into account for the calculation of the maturity of the tranche and, hence, the corresponding capital requirements

4.5 Methodology for determining the contractual payments due under the tranche in relation to synthetic securitisations

4.5.1 Contractual payments to be made under the credit protection agreement

57. Institutions should determine the contractual payments of premia. [*In the case of funded credit protection, the contractual payments should additionally include the reimbursement of the collateral pledged and any interest or coupons collected by the protection providers from the collateral.]* The contractual payments should be determined in accordance with the contractual terms and conditions of the transaction as defined in the securitisation transaction documentation.

Premia that are contingent on the size of the protected tranche

58. Where the contractual payments of premia are contingent on the size of the tranche to which positions with the credit protection are associated, institutions should model the outstanding balance of the securitised portfolio for the coming periods, until the final legal maturity of the transaction, following the methodology set out in section 4.3.2 for performing securitised exposures in traditional securitisations.

59. Institutions should take into account the amortisation system set out in the credit protection agreement in order to determine the size of the tranche to which position with the credit protection are associated and should assume that the amortisation system of the tranches as of the date of calculation of the WAM would be applicable throughout the life of the transaction.

60. Where the contract already envisages that the amortisation system applicable in future periods changes according to a completely predetermined manner so that the exact value of the amortisation applicable in a future period can already be determined at the respective WAM calculation date, institutions should take those future contractual terms into account.

61. Where the guarantee or the contract includes a trigger that changes the amortisation system from one system to another, e.g. from pro-rata to sequential, based on certain

triggers to be met, e.g. the performance of the securitised exposures, that trigger should not be considered unless it has already been triggered at the date of calculation of the WAM.

62. Optional contractual features, such as step-up calls, put options, regulatory and tax calls, which would reduce the maturity of the tranche, should not be considered in the calculation of the WAM.

63. By way of derogation from the previous paragraph, clean-up calls in accordance with Article 245(4)(f) of Regulation (EU) No 575/2013 that permit early termination of the contract before the securitised exposures are fully amortised, may be taken into account.

Explanatory text for consultation purposes

Institutions should model the outstanding balance of the tranches, based on that of the securitised portfolio for the coming periods, until the final legal maturity of the transaction, following the methodology set out for performing securitised exposures in traditional securitisations. As no future defaults or losses are proposed to be taken into account for the calculation of WAM in traditional securitisations, the implication in synthetic securitisations is that no modelling of future losses covered by the protection contract should be considered for the calculation of WAM either. However, when defaults occur and generate losses, the related compensations paid to the originator should be taken into account for the determination of the WAM, and the outstanding balance of the protected tranche should be adjusted accordingly.

Question 6: In synthetic securitisations, do you agree that no modelling of future non-occurred losses should be allowed in order to calculate the future outstanding balance of the underlying portfolio and the tranches? Or do you think that the modelling of losses should be taken into account? If so, could you provide the rationale supporting your views and the impact on risk-weighted exposure amounts?

Question 7. In synthetic securitisations, do you agree that only clean-up calls in accordance with Article 245(4)(f) of the CRR should be taken into account to determine the WAM? In your view, should time calls, which can be exercised by the protection buyer after the WAL of the underlying portfolio (as defined in paragraph 53 of the Guidelines on the STS criteria for ABCP securitisation), also be taken into account? If so, could you provide the rationale supporting your views and the impact on risk-weighted exposure amounts?

Premia that are not contingent on the size of the protected tranche

64. Where the contractual payments of premia are not contingent on the size of the tranche to which positions with [*unfunded*] credit protection are associated, institutions should not model the outstanding balance of the securitised portfolio for the coming periods and should instead take into account the periodic payments of the premia as set out in the contract. [*However, in the case of funded credit protection, institution should model the outstanding balance of the securitised portfolio for the coming periods, and the corresponding size of the protected tranches, for the purpose of determining the reimbursement of the collateral and its interest and coupons for the coming periods*.]

65. By way of derogation from the previous paragraph, where those periodic payments of the premia are front-loaded, meaning that more than half of the total premia is expected to be paid before half the duration of the contract, or the premium is paid up-front, institutions should not consider any contractual payments applicable for the purposes of WAM.

Explanatory text for consultation purposes

In order to avoid arbitrage where premia are not contingent to the size of the protected tranche, as this would give institutions flexibility to shorten the WAM of protected tranches and all more senior tranches at will, institutions should not calculate the WAM of the tranche and should rely on the final legal maturity of the contract to measure the maturity of the tranche where the payments of premia are up-front or front-loaded

4.6 Implementation and use of the WAM model

4.6.1 Update of the model

66. Institutions should only rely on third party model providers when they have carried out appropriate due diligence to ensure both the compliance of the third party with the guidelines and an appropriate level of market expertise of the third party in cash flow modelling and its thorough understanding of securitisation.

67. Institutions and third party model providers should have the expertise and capacity to maintain a cash flow model that accurately reflects the prevailing characteristics of the underlying portfolio and of the transaction at the date of calculation of the WAM.

68. The model should be monitored and updated whenever necessary to account for i) any variations of the key parameters including the outstanding note balance, the status of the triggers and the performance of the transaction and ii) any other material changes to the transaction which may include the restructuring of the notes or of the underlying exposures.

4.6.2 Model validation and quality review

69. The asset and liability models should be subject to an initial review provided by the staff of the institution performing the validation function, who should be separate from the staff responsible for model design or development, or by an external independent auditor, all of which should have a demonstrable expertise in cash flow modelling and a thorough understanding of securitisation. The consistency, reliability and transparency of the asset and liability model should also be reviewed annually on a sample basis by the staff of the institution performing the validation function or the internal audit. The independent review should in particular assess:

a. the quality of the process to gather the input data used in the asset model and the representativeness of the input data;

b. the accuracy of the process to gather the key parameters with regard to the terms and conditions of the transaction documentation;

c. the correctness of the overall calculation

70. The independent review should provide the institution with a documentation specifying whether it agrees that the asset and liability models produced valid results and stating, where relevant, recommendations on adjustments that could improve the quality of the asset and liability models.

Question 8. What are your views on the model validation and quality review of the asset and liability models and on due diligence on third party model providers? Do you perceive it as too burdensome? If so, please provide alternative proposals to account for compliance of third party model providers with these guidelines and for the assessment of the quality and accuracy of the asset and liability models

Question 9. Are there any other issues that you would consider necessary to comment on? If so, please provide them with the alternatives to the wording adopted in these draft guidelines

4.6.3 Implementation by institutions

71. Institutions opting for the WAM approach under point (a) of Article 257(1) of Regulation (EU) No 575/2013 should apply it in a consistent way across all the securitisation positions that belong to the same securitisation transaction, with the exception of tranches of a synthetic securitisation subordinated to all tranches receiving protection and protected tranches in which the premia are front loaded or are paid upfront, in respect of which the final legal maturity should be used.

72. Where the WAM is used to determine the own funds requirements for securitisation positions in accordance with the SEC-IRBA or SEC-ERBA, the WAM of each securitisation position as determined for the respective tranche should be calculated and updated at least on a quarterly basis.

73. Once an institution has decided to determine the maturity of a securitisation position using the WAM approach in point (a) of Article 257(1) of Regulation (EU) No 575/2013, it should apply the WAM approach consistently within the boundaries of Article 257(2) of that Regulation until the institution ceases to hold that securitisation position. As an exception, when the final legal maturity falls below one year, institutions may stop using the WAM approach.

5. Accompanying documents

Cost-benefit analysis/ impact assessment

1. As per Article 16(2) of the EBA Regulation (Regulation (EU) No 1093/2010), guidelines developed by the EBA shall be, where appropriate, accompanied by an impact assessment which analyses the related potential related costs and benefits. This section provides an overview of such impact assessment, and the potential costs and benefits associated with the implementation of the guidelines.

Problem identification

2. The guidelines have been developed in accordance with the mandate assigned to the EBA in Article 257(4) of the CRR, which requests the EBA to monitor the range of practices in the determination of the maturity of a tranche of a securitisation transaction, with particular regard to the application of point (a) of paragraph 1 of Article 257, and, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines by 31 December 2019

3. One of the major shortcomings of the Basel II securitisation framework, and of the CRR before the 2017 amendment, was the sharp cliff effects in marginal capital charges. The Basel Committee considered that this was driven in part due to the lack of an adequate incorporation of maturity, as the Basel II securitisation framework looked only at the risk of default over a 1-year horizon, ignoring the risk of a potential deterioration afterwards; implicitly assuming that a given tranche will not incur any market value loss until the values for all more-junior tranches have been reduced to zero.

4. On the understanding that the use of the final legal maturity is overly conservative and does not reflect the real maturity of the tranche, the Basel Committee agreed to apply a haircut in order to smooth the impact of tranche maturity on capital charges when final legal maturity is used. This has also been considered in Article 257(1)(b) of the CRR as amended. Nevertheless, in order to provide a more precise measurement of tranche maturity, Article 257(1)(a) of the CRR as amended sets out the option for institutions of calculating tranche maturity as the weighted average maturity (WAM) of the contractual payments due under the tranche.

Policy objectives

5. The main objectives of these guidelines is to ensure that the methodology applicable for the determination of theWAM for regulatory purposes is sufficiently harmonised in order to increase consistency and comparability in the own funds held by institutions. This methodology should also be clear, to avoid arbitrage and allow for its usage by less

sophisticated institutions using SEC-ERBA; conservative, to maintain a sufficient level of prudence; and simple, to facilitate the supervision by competent authorities.

Assessment of the options adopted

6. In the case of traditional securitisations, the EBA has addressed the legal mandate by interpreting the wording of Article 257(1)(a) in a way that makes the WAM approach applicable in practice. In the case of traditional securitisations, the EBA understands that the contractual payments due under the tranche mean the combination of 1) the contractual payments of the borrowers in relation to the underlying exposures payable to the SSPE and 2) the contractual payments payable by the SSPE to the tranche holders. A more restrictive interpretation, considering the second leg only (i.e. the contractual payments payable by the SSPE to the tranche holders), would have limited the application of the WAM approach to those tranches with fixed contractual payments only, which are not the most common tranches in a securitisation, as in most cases the payments that the tranche holders receive depend in one way or another on the performance of the securitised exposures.

7. In the case of synthetic securitisations, the EBA believes that the wording of Article 257(1)(a) gives no room to adopt the current market practice of considering the weighted average life of the securitised exposures as the maturity of the tranche. In consequence, the EBA has addressed the legal mandate by following strictly the wording of Article 257(1)(a) and considers that the contractual payments due under the tranche mean the contractual payments of premia payable to the protection providers by the originator buying protection for a tranche [*and, in the case of funded credit protection, the reimbursement of the collateral pledged and any interest or coupons to be collected by the protection providers from the collateral as well]*. Nevertheless, a strict interpretation of Article 257(1)(a) would lead to a situation in which only the protected tranches (i.e. the mezzanine or first loss tranches) would be within the scope of the WAM approach and the more senior tranches that benefit from the tranching of risk created by the protection agreement would not and therefore subject to measurement of their maturity based on the final legal maturity of Article 257(1)(b). As this interpretation would lead to a counterintuitive application of the WAM approach, the EBA considers that the contractual payments of the protected tranches should also be taken into account when calculating the WAM of tranches that are more senior to them.

Cost-benefit analysis

8. It is expected that the implementation of these guidelines will improve the risk sensitiveness of the securitisation framework for credit risk in Part Three, Title II, Chapter 5 of the CRR, as one of the main risk drivers will be measured in a more precise way. This will bring about

benefits for originators, investors and sponsors in the case of tranches for which the maturity cap of 5 years or the floor of 1 year are not binding by reducing, in most cases, the capital requirements of the tranches held by them, and consequently will incentivize the transfer of risk via securitisation and contribute to a broader and deeper securitisation market in the EU, one of the main objectives of the European Commission's Capital Market Union initiative. This is likely to more than offset the additional costs connected with the development of the asset and liability models foreseen in these guidelines and the internal governance requirements imposed consequently.

Impact assessment

9. The EBA has conducted an impact assessment in two ways. In the case of traditional securitisations, by analyzing the available information for EU banks in the C14 template on securitisation details of the ITS on supervisory reporting as of 31.12.2018, and in the case of synthetic securitisations, because of the interpretation of the WAM approach adopted differs from current market practices C14 template was not useful, by analyzing the impact for a set of stylized transactions.

10. The final legal maturity and the first foreseeable termination date of the transaction (FFTD) are reported in the C14 template. Considering the FFTD as a proxy of the WAM of a tranche in the presence of **pro-rata amortisation**, the analysis shows that for the traditional transactions for which the FFTD is available, the FFTD was below the final legal maturity in 35% of the cases only, and only in such cases the WAM is of benefit to institutions. However, it is reasonable to think that in the case of the most senior tranches of transactions subject to a **sequential amortization** the number of cases wherethe WAM is below the final legal maturity would be significantly higher.

11. Concerning the impact of the use of the WAM approach on risk-weights in traditional securitisations, it differs depending on the approach used for its calculation. In the case of SEC-IRBA, the analysis shows the following:
    - For transaction with a high K_{IRB} (e.g. NPL securitisations) there is no difference when the WAM or the final legal maturity are applied. This is because the tranche maturity is only one of the inputs of the P factor formula, and high levels of K_{IRB}, which has a negative influence in the formula, leads the P factor to the floor of 0.3 no matter the tranche maturity value
    - In the case of performing securitised portfolios, there is no relevant impact on certain senior and mezzanine tranches because the risk weight floor applies irrespective of whether the final legal maturity or the WAM are used. However, assuming a **pro-rata amortisation** of all the tranches of the transactions for which the FFTD was below the final legal maturity, risk weights when applying the WAM approach would be around 20% less in relative terms compared to applying the

final legal maturity, which would be higher for the most senior ones in the presence of **sequential amortisation**

12. Nevertheless, in the case of SEC-ERBA, the impact on risk weights of the use of the WAM is expected to be especially relevant. This is because in order to determine the risk weigths for tranches with maturity between 1 and 5 years institutions shall use the linear interpolation between the risk weight for 1 and 5 years, so that any reduction in tranche maturity in this range will reduce the risk weights of the tranches. This linear interpolation gives full credit in all cases, except for STS tranches of credit quality step 1, in terms of reduction in risk weights, when the WAM is lower than the final legal maturity as adjusted in accordance with Art 257(1)(b). However, the higher the difference in risk weights between the columns for 1 year and 5 years in the SEC-ERBA look-up table the higher the impact of the use of the WAM approach in absolute terms.

13. In the case of synthetic securitisations [*under unfunded credit protection]*, based on an analysis of stylised transactions with final legal maturity of the protection contracts below 5 years, the WAM of the tranches tend to be slightly below the WAL of the securitised portfolio, which in turn is below the final legal maturity of the transaction, when the amortisation of the tranches is on a **pro-rata basis**. However, in presence of **sequential amortisation** of the tranches, WAM tend to be higher than WAL but below the final legal maturity of the transaction. The main difference with the analysis made on traditional securitisations above is that the impact, in terms of reduction of risk weights, is higher for senior tranches when the amortisation is on a pro-rata basis because the effect of higher premia to be paid increases WAM in sequential amortization

14. • [*According to the impact assessment, the consideration of the cash flows from the reimbursement of the collateral and its interest or coupons in synthetic securitisation under funded credit protection agreements provides a more conservative estimation of WAM than when computing the premia only. The WAM would be generally higher than the WAL of the securitised exposures under a pro-rata amortisation, and would be close to the final legal maturity under a sequential amortisation*.]