

# Basel Committee on Banking Supervision

## Consultative Document

### Capital treatment for “simple, transparent and comparable” securitisations

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# Capital treatment for “simple, transparent and comparable” securitisations

## 1. Introduction

The Basel Committee published the revised securitisation framework in December 2014.<sup>1</sup> Criteria for “simple, transparent and comparable” (STC) securitisations, developed jointly by the Basel Committee and the International Organization of Securities Commissions (IOSCO), were published for consultation on the same date.<sup>2</sup> At that time, the Committee announced that, once the criteria had been finalised, it would consider how to incorporate these STC criteria into the capital framework.

Final STC criteria were published in July 2015 (BCBS-IOSCO July 2015 STC criteria).<sup>3</sup> This consultative document explains the rationale for incorporating the STC criteria into the revised securitisation framework and proposed options for doing so.

## 2. Incorporating the BCBS-IOSCO July 2015 STC criteria into the capital framework

### Background on the STC criteria

The STC criteria are intended to help transaction parties – including originators, investors and other parties with a fiduciary responsibility – evaluate more thoroughly the risks and returns of a particular securitisation, and to enable more straightforward comparison across securitisation products within an asset class. These criteria should assist investors in undertaking their due diligence on securitisations, but in no case would these criteria serve as a substitute for such due diligence.

The STC criteria may help both investors and supervisors assess the risk of securitisation exposures by fostering simplicity in the underlying assets and the structures of securitisations meeting such criteria. By improving transparency, the STC criteria may help provide investors throughout the life of the transaction with greater access to comprehensive and reliable information about the securitisation structure and their underlying assets’ characteristics and performance. By incentivising a greater comparability for certain elements of securitisation transactions, the STC criteria could lower investors’ hurdle for assessing securitisation risks.

<sup>1</sup> Available at: [www.bis.org/bcbs/publ/d303.pdf](http://www.bis.org/bcbs/publ/d303.pdf).

<sup>2</sup> Available at: [www.bis.org/bcbs/publ/d304.pdf](http://www.bis.org/bcbs/publ/d304.pdf).

<sup>3</sup> Available at: [www.bis.org/bcbs/publ/d332.pdf](http://www.bis.org/bcbs/publ/d332.pdf).

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## What does STC mean?

<b>Simplicity</b>	Simplicity refers to the homogeneity of underlying assets with simple characteristics, and a transaction structure that is not overly complex.
<b>Transparency</b>	Criteria for transparency provide investors with sufficient information on the underlying assets, the structure of the transaction and the parties involved in the transaction, thereby promoting a more comprehensive and thorough understanding of the risks involved. The manner in which the information is available should not hinder transparency, but instead support investors in their assessment.
<b>Comparability</b>	Criteria promoting comparability could assist investors in their understanding of such investments and enable more straightforward comparison across securitisation products within an asset class. Importantly, they should appropriately take into account differences across jurisdictions.

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## Rationale for introducing STC criteria into the capital framework

The December 2014 framework takes into account some important factors, including pool credit quality and attachment and detachment points of tranches. Notwithstanding, the December 2014 framework does not capture some of the features (especially the qualitative ones) of securitisation structures found in the marketplace. Arguably, STC criteria are better able to capture the nuances and qualitative elements of structures, thus increasing confidence as to how these transactions will perform. The criteria help mitigate uncertainty related to asset risk, structural risk, governance, and operational risk.

Additional confidence in the performance of STC transactions may justify a reduction in the conservatism built into the capital framework through the non-neutrality of the capital framework. The non-neutrality of the framework refers to the fact that the total capital required for a securitisation (ie the sum of the capital required for all securitisation tranches) is greater than the amount of capital required for the underlying assets.<sup>4</sup> All other things being equal, a securitisation with lower structural risk needs a lower capital surcharge than a securitisation with higher structural risk; and a securitisation with less risky underlying assets requires a lower capital surcharge than a securitisation with riskier underlying assets.

Q1. Do respondents agree with the rationale for introducing STC criteria into the capital framework? Are there any other aspects that the Committee should consider before introducing STC criteria into the capital framework that are not already reflected in the rationale above?

<sup>4</sup> In the formula-based approaches, positions detaching below  $K_{IRB}/K_{SA}$  receive a 1250% risk weight. Capital non-neutrality arises from the capital charges on tranches detaching above  $K_{IRB}/K_{SA}$ , which receive risk weights that are lower than 1250%. In the formula-based approaches, non-neutrality is controlled directly, through a direct input parameter ( $p$ ), which is a measure of the capital surcharge on the tranches relative to underlying pool capital (ie a “ $p$ ” equal to 1 means a capital surcharge of 100% over the capital requirements for the underlying assets). Furthermore, further contributors to the non-neutrality are the floor risk weight (of 15% in the December 2014 framework) and, in the case of the Securitisation Standardised Approach the delinquency parameter  $w$  that adjusts the underlying  $K_{SA}$  capital feeding into the formula.

## Scope of the STC framework for capital purposes

The revisions to the December 2014 framework proposed in this consultative document are included in Annex 2. These revisions affect neither asset-backed commercial paper (ABCP) programmes nor synthetic securitisations.

The BCBS-IOSCO July 2015 STC criteria explicitly excluded short-term securitisations (and more specifically, ABCP programmes<sup>5</sup>) from the scope of the criteria. The Committee and IOSCO are currently considering whether, and how, STC criteria for this type of securitisations should also be issued. If the Committee and IOSCO finally publish STC criteria on ABCP programmes, the Committee will in turn determine how to incorporate them in the revised securitisation framework.

The July 2015 STC criteria did not, however, explicitly exclude synthetic securitisations from the scope of STC application.<sup>6</sup> The objective of the Committee and IOSCO when drafting the July 2015 STC criteria was to revitalise sustainable securitisation markets, and this was seen as incompatible with allowing synthetics to qualify as STCs. Nevertheless, the Committee is of the view that synthetic securitisations should not be under the scope of the STC framework for regulatory capital purposes (proposed in this document). All synthetic securitisations will remain subject to capital requirements as determined by the December 2014 framework.

## Definition of STC securitisation for regulatory capital purposes

When publishing the July 2015 STC criteria, the Committee and IOSCO noted that additional and/or more detailed criteria may be necessary with respect to setting regulatory capital requirements, especially for the credit risk of underlying assets. While the criteria developed by the Committee and IOSCO are detailed enough to serve as guideposts for good practice, the use of the criteria for the setting of preferential regulatory capital requirements requires greater prescriptiveness. The Committee has therefore decided to supplement the July 2015 STC criteria with additional criteria for the specific purpose of differentiating the capital treatment between STC and other securitisation transactions.

For the purpose of this consultation paper, STC securitisations qualifying for differentiated regulatory capital treatment are securitisations (as defined under the Basel 2014 framework) meeting both the BCBS-IOSCO July 2015 STC criteria (as interpreted for their application to the regulatory capital framework – see Annex 1, criteria A1 to C14), as well as the additional criteria proposed in this consultative document (see Annex 1, criteria D15 to D17). The expanded set of criteria will be referred to as STC criteria for regulatory capital purposes. Exposures in STC securitisations qualifying for regulatory capital treatment will be subject to the lower capital requirements which are the subject of this consultation.

Q2. Do respondents agree that, for the purpose of alternative capital treatment, additional criteria are required? What are respondents' views regarding the additional criteria presented in Annex 1?

<sup>5</sup> While the July 2015 STC criteria excluded "short-term securitisations instruments" from the scope of the STC criteria, the Committee understands that this exemption was primarily aimed at ABCP. Short-term securitisation instruments other than ABCP should not be prevented from qualifying for STC status simply because their maturity is shorter than one year, provided that they qualify under the existing STC criteria. By contrast, the Committee acknowledges that, due to their specific structure, ABCP programmes would not meet all STC criteria. Consequently, the Committee proposes to keep short-term securitisation instruments other than ABCP within the scope of the STC framework.

<sup>6</sup> Consequently, under the BCBS-IOSCO July 2015 STC criteria, synthetic securitisations would be considered non STC securitisations because they do not meet the criterion of true sale.

### 3. Considerations around the STC criteria

#### (i) Enhancements to the criteria for regulatory capital purposes

For the specific purpose of differentiating the capital treatment of exposures to STC securitisations qualifying for differentiated regulatory capital treatment, the Committee proposes additional language (contained in Annex 1) to supplement the BCBS-IOSCO July 2015 STC criteria in order to make them operational for use in the capital framework, without modifying the criteria themselves. The proposed enhancements include clarifications as well as additional requirements. The most material enhancements to the criteria are as follows:

- **More explicit requirements for minimum performance history** (added to the base criterion A2), incorporating language used within the Basel IRB framework.
- **The exclusion of transactions if standardised risk weights for the underlying exceed certain levels** (new criterion D15). The Committee proposes to add such requirements to help ensure that higher-risk underlying exposures would not be able to qualify for alternative treatment as STC-compliant transactions. (The exact risk weight cut-offs to be used would need to be revisited once the ongoing revisions to the Standardised Approach are finalised.)
- **A more explicit definition of granularity** (new criterion D16). With this, the Committee intends to provide clarity as to how granular a pool must be, and proposes that no single exposure should comprise more than 1% of the underlying pool.
- **A higher standard under fiduciary and contractual responsibilities** (new criterion D17). The Committee wants to strengthen the linkage of the most important parties to a securitisation transaction, the originator of the assets and the servicer of the assets, by requiring that these two roles be served by the same legal entity, or affiliates with a common parent entity. An exception to this requirement would be made explicitly for residential mortgages, and only in jurisdictions where it is common practice to employ a third-party servicer.

The Committee considers that the STC criteria are generally clear as to when they need to be met. Checking compliance with some of the criteria might only be necessary at origination (or at the time of initiating the exposure, in the case of guarantees or liquidity facilities) of an STC securitisation qualifying for differentiated regulatory capital treatment, with the understanding that investors and holders of the securitisation positions must thereafter take into account developments that may invalidate the previous STC assessment, for example deficiencies in the frequency and content of the investor reports, in the alignment of interest, or changes in the transaction documentation leading to variance with relevant STC criteria for regulatory capital purposes. However, in some cases, for example where the criteria refer to underlying assets in a dynamic pool, compliance with the criteria should be reassessed every time assets are added to the pool.

#### (ii) Determining compliance

The Committee has also considered how the determination of compliance with the STC criteria for regulatory capital purpose should be made, and recommends that, in order for a given tranche to



receive an alternative capital treatment, both the originator/sponsor<sup>7</sup> and investor must assert that a securitisation/tranche is compliant with the STC criteria for regulatory capital purpose.

Requiring the originator/sponsor to assess compliance with the STC criteria for regulatory capital purpose helps to ensure that it will make the necessary information for the assessment publicly available or, at least, available to the parties interested in the transaction. While the originator/sponsor is the party most likely to have all of the information necessary to assess STC compliance, having the originator/sponsor alone designate STC compliance could induce less rigorous due diligence by the investor. Therefore the investor will nonetheless be required to make the determination before applying the alternative capital treatment, independently from the originator/sponsor. This would help to ensure that the investor conducts the necessary due diligence when purchasing a securitisation tranche. It would also help to avoid any STC designation made by the originator/sponsor from being viewed as a "guarantee" of good performance. Finally, the complementary designation would prevent greater inconsistencies as to the STC status across investors in the same securitisation transaction if only the investor were required to determine compliance.

Another option would be to have a third party (such as a rating agency, a law firm, or an audit firm) make the designation. However, such a requirement could lead to significant additional costs and might also be contrary to the high-level concept of reducing reliance on external assessments (such as ratings) in the sense that a third party would then be in control of an important stamp of approval that would determine regulatory capital treatment.

The Committee also considered whether regulators could make the designation, but decided that it would be too costly and time consuming for regulators to establish a "certification" process given the number of securitisation deals executed each year and given the number of securitisation structures outstanding. Moreover, a regulatory "stamp of approval" may also raise issues of moral hazard, as investors would have less incentive to perform rigorous due diligence.

### (iii) Role of supervisors in the determination of STC compliance

While originator/sponsors and investors would assess compliance with the STC criteria for regulatory capital purposes, supervisors would review the preferential regulatory capital treatment assignments made by the banks that they supervise (ie the investors in the securitisation transactions and originators retaining some exposures in their securitisations). This review would be part of the normal supervisory process of each jurisdiction that incorporates the qualifying STC securitisation criteria into its securitisation framework. Should a supervisor not be satisfied with a bank's determination that a given transaction satisfies the STC criteria for regulatory capital purposes, it should take remedial action (for instance, under the Pillar 2 framework, or by denying preferential regulatory capital treatment for that specific transaction and potentially others as well).

All STC transactions must be certified as STC by the written attestation of the securitising parties (ie originator and/or sponsor, as appropriate) in the transaction's legal offering documents (or equivalent). The transaction and the securitising party(ies), solely in its/their role in originating and/or

<sup>7</sup> Throughout this document, the term originator/sponsor refers to the party that organises and initiates a securitisation transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity. It is noted that the term "sponsor" does not perfectly overlap across jurisdictions. For example, while in the United States the term "sponsor" is understood to be the primary party organising the securitisation, in the EU "sponsor" is only defined in the context of asset-backed commercial paper programmes or other securitisation schemes that purchase exposures from third-party entities. Therefore, in the context of EU deals, the entity typically subject to this requirement would be designated as the "originator".

sponsoring the STC securities issuance, must be subject to oversight by a regulatory authority, and the securitising party(ies) must be subject to legal liability or regulatory action with respect to material misrepresentations or omissions regarding the transaction's satisfaction of the STC criteria.

Q3. What are respondents' views on the compliance mechanism and the supervision of compliance presented in this consultative document?

## 4. Proposed revisions to the December 2014 framework to incorporate the STC criteria

### Introduction

While incorporating the STC framework into the December 2014 securitisation framework could increase its risk sensitivity, it might also introduce significant operational burdens. In view of this trade-off, jurisdictions that consider that implementation costs exceed potential benefits will retain the option not to implement the STC framework as proposed in this consultative document.

For jurisdictions choosing to incorporate the STC framework, differentiated capital charges would apply to all exposures in securitisations qualifying for differentiated regulatory capital treatment, irrespective of its seniority, given that all tranches benefit from the lower structural and asset risks in STC securitisations. Exposures in securitisations not meeting the STC criteria for regulatory capital purpose would continue to be subject to the treatment detailed in the December 2014 securitisation framework.

### Alternative treatment of exposures in STC securitisations

The sources of risk of a securitisation transaction are the credit risk of the underlying exposures that are being securitised and the securitisation process itself – ie the tranching and packaging of this risk. The BCBS-IOSCO July 2015 STC criteria are primarily designed to mitigate securitisation risks, resulting in transactions that have lower structural risk, and therefore model risk. The requirements added to the BCBS-IOSCO July 2015 STC criteria for its application in the regulatory capital framework (especially the new criterion D15) aims to limit the credit risk of assets underlying STC transactions.

This additional confidence in the performance of STC transactions qualifying for differentiated regulatory capital treatment justifies a reduction in the conservatism built into the capital framework, including the risk weight floor (whose primary reason is to protect against model risk), as well as the degree of non-neutrality in the capital framework, which - as noted before- is primarily controlled by the supervisory parameter "p" within the Internal Ratings-Based Approach (SEC-IRB) and the Standardised Approach (SEC-SA).

With this in mind, the alternative treatment of exposures in STC securitisations qualifying for differentiated regulatory capital treatment is proposed as:

- A reduction in the floor of senior exposures in such STC securitisations from 15% to a risk weight floor in the range between [10-12]%, across all approaches. The floor of 15% is maintained for mezzanine tranches. The difference in floor risk weights for senior and non-senior tranches is aimed at preserving prudent levels of capital for non-senior tranches, even if they met the STC criteria.
- A rescaling of the p-parameter by a factor in the range between [0.6–0.8] under the formula-based approaches, SEC-IRBA and SEC-SA (Table 1).

- A rescaling of the External Ratings-Based Approach (SEC-ERBA) risk weights that achieves an impact similar to the rescaling of the p-parameter in the formula-based approaches (Tables 2a, 2b and Table 3a and 3b). This rescaling benefits all exposures to an STC securitisation (excluding those subject to a 1,250% risk weight).

The proposed calibration in Tables 1, 2 and 3 will be refined based on a QIS exercise to be conducted concurrent with the consultation period.

Table 1: Rescaling of p-parameter under the formula-based approaches for STC-compliant tranches

<b>SEC-IRBA</b>	The (x) factor in the range of [0.6 - 0.8] is applied to p, while preserving the prudential floor of p at 0.3: $p_{STC} = \max[0.3; [x] \times (A + B * (\frac{1}{N}) + C * K_{irb} + D * LGD + E * M_t)]$
<b>SEC-SA</b>	The supervisory parameter p is rescaled from 1 to a lower number in the range [0.6 - 0.8].

Table 2a presents a possible recalibration of the SEC-ERBA risk weights for exposures rated under the long-term ratings frameworks under the scenario in which a p-factor of 0.6 and a risk weight floor of 10% for senior exposures are applied. Table 2b presents risk weights for STC securitisations with a short-term rating under the same changes to the p-factor and the risk weight floor. Table 3a and 3b present possible SEC-ERBA risk weights – for long and short term ratings - under the scenario in which a p-factor of 0.8 and a risk weight floor of 12% for senior exposures are applied.

Table 2: ERBA risk weights for STC securitisations and other securitisations when a p-factor of 0.6 and a risk weight floor of 10% for senior exposures are applied  
 Non-STC risk weights are the same as in the December 2014 revised securitisation framework;  
 proposed STC risk weights are shown in parenthesis

(a) For long-term ratings:

Rating	Senior tranche		Non-senior (thin) tranche	
	<i>Tranche maturity (M<sub>T</sub>)</i>		<i>Tranche maturity (M<sub>T</sub>)</i>	
	<i>1 year</i>	<i>5 years</i>	<i>1 year</i>	<i>5 years</i>
AAA	15% (10%)	20% (15%)	15% (15%)	70% (45%)
AA+	15% (10%)	30% (20%)	15% (15%)	90% (60%)
AA	25% (15%)	40% (25%)	30% (20%)	120% (75%)
AA-	30% (20%)	45% (30%)	40% (25%)	140% (90%)
A+	40% (30%)	50% (35%)	60% (40%)	160% (110%)
A	50% (35%)	65% (45%)	80% (55%)	180% (125%)
A-	60% (40%)	70% (50%)	120% (85%)	210% (150%)
BBB+	75% (60%)	90% (70%)	170% (135%)	260% (205%)
BBB	90% (70%)	105% (80%)	220% (175%)	310% (245%)
BBB-	120% (95%)	140% (110%)	330% (260%)	420% (330%)
BB+	140% (115%)	160% (130%)	470% (390%)	580% (480%)
BB	160% (130%)	180% (150%)	620% (515%)	760% (630%)
BB-	200% (165%)	225% (185%)	750% (620%)	860% (710%)
B+	250% (220%)	280% (245%)	900% (785%)	950% (830%)
B	310% (270%)	340% (295%)	1,050% (920%)	1,050% (920%)
B-	380% (330%)	420% (365%)	1,130% (990%)	1,130% (990%)
CCC+/CCC/CCC-	460% (410%)	505% (450%)	1,250% (1,250%)	1,250% (1,250%)
Below CCC-	1,250% (1,250%)	1,250% (1,250%)	1,250% (1,250%)	1,250% (1,250%)

(b) For short-term ratings:

<i>External credit assessment</i>	<i>A-1/P-1</i>	<i>A-2/P-2</i>	<i>A-3/P-3</i>	<i>All other ratings</i>
Risk weight	15% (10%)	50% (35%)	100% (80%)	1,250% (1,250%)

Table 3: ERBA risk weights for STC securitisations and other securitisations when a p-factor of 0.8 and a risk weight floor of 12% for senior exposures are applied  
 Non-STC risk weights are the same as in December 2014 framework; proposed STC risk weights are shown in parenthesis

(a) For long-term ratings:

Rating	Senior tranche		Non-senior (thin) tranche	
	<i>Tranche maturity (M<sub>T</sub>)</i>		<i>Tranche maturity (M<sub>T</sub>)</i>	
	<i>1 year</i>	<i>5 years</i>	<i>1 year</i>	<i>5 years</i>
AAA	15% (12%)	20% (15%)	15% (15%)	70% (55%)
AA+	15% (12%)	30% (25%)	15% (15%)	90% (70%)
AA	25% (20%)	40% (30%)	30% (25%)	120% (95%)
AA-	30% (25%)	45% (35%)	40% (30%)	140% (110%)
A+	40% (35%)	50% (40%)	60% (50%)	160% (135%)
A	50% (40%)	65% (55%)	80% (65%)	180% (150%)
A-	60% (50%)	70% (60%)	120% (100%)	210% (175%)
BBB+	75% (65%)	90% (80%)	170% (155%)	260% (235%)
BBB	90% (80%)	105% (95%)	220% (200%)	310% (280%)
BBB-	120% (110%)	140% (125%)	330% (300%)	420% (380%)
BB+	140% (130%)	160% (145%)	470% (435%)	580% (535%)
BB	160% (145%)	180% (165%)	620% (575%)	760% (700%)
BB-	200% (185%)	225% (210%)	750% (695%)	860% (795%)
B+	250% (235%)	280% (260%)	900% (845%)	950% (890%)
B	310% (290%)	340% (320%)	1,050% (985%)	1,050% (985%)
B-	380% (355%)	420% (395%)	1,130% (1060%)	1,130% (1060%)
CCC+/CCC/CCC-	460% (435%)	505% (480%)	1,250% (1,250%)	1,250% (1,250%)
Below CCC-	1,250% (1,250%)	1,250% (1,250%)	1,250% (1,250%)	1,250% (1,250%)

(b) For short-term ratings:

<i>External credit assessment</i>	<i>A-1/P-1</i>	<i>A-2/P-2</i>	<i>A-3/P-3</i>	<i>All other ratings</i>
Risk weight	15% (12%)	50% (40%)	100% (90%)	1,250% (1,250%)

Q4. What are respondents' views on the alternative capital requirements for STC securitisation presented in this consultative document?

## 5. QIS

The Committee will conduct a comprehensive QIS exercise collecting data to inform the Committee's consideration of the calibration for STC securitisations qualifying for differentiated regulatory capital treatment.

Participants will be asked to report:

- (a) All of their securitisation exposures, mapped to a closed list of securitisation asset classes. Participants will be asked to compute risk weights for each securitisation exposure under this proposed STC framework and the December 2014 framework.

The Committee will make a determination based on its own assessment of which of these asset classes are likely to have qualified as STC for the purposes of a differentiated regulatory capital treatment, and how, had the framework already been in place. Such a classification involves by design a certain number of simplifying assumptions, which are nonetheless necessary for the purposes of the QIS. This simplification does not represent in any way an endorsement by the Committee that certain asset classes as a whole would qualify as STC. Every securitisation asset class remains heterogeneous – in some cases, highly so – no matter how deep the breakdown used;

- (b) A representative subset of securitisation exposures where more detailed information will be required. This would allow the Committee to make a more accurate assessment as to the current bank securitisation holdings and the potential STC status of the respective exposure, and give more flexibility in assessing calibration options.

Participants will be required to calculate risk-weighted assets under two frameworks:

1. The December 2014 revised securitisation framework;
2. The STC framework for regulatory capital purposes, under two scenarios representing the boundaries of the calibration options considered by the Committee

The Committee encourages market participants to contact their national supervisors if they wish to participate in the QIS on a best-efforts basis. Extensive and high quality data will be crucial in supporting appropriate adjustments for STC transactions in the calibration of the securitisation framework.

## 6. Monitoring period

Given that decisions on whether STC criteria are met will be assessed by originators and investors, the Committee plans to closely monitor over the early years of implementation the determinations of STC securitisations for regulatory capital purposes, to ensure that implementation is consistent across jurisdictions.

The evaluation will focus on the design of the STC determination process and its implementation by securitising parties and investors, as well as on the role of regulators and supervisors in the determination process.

## 7. Next steps

The Committee encourages market participants to engage in a constructive dialogue during the consultation period, and to participate in the QIS on a best-efforts basis.

The Committee welcomes comments on all aspects of this consultative document and the proposed standards text.

Comments on the proposals should be uploaded by Friday 5 February 2016 using the following link: [www.bis.org/bcbs/commentupload.htm](http://www.bis.org/bcbs/commentupload.htm). All comments will be published on the website of the Bank for International Settlements unless a respondent specifically requests confidential treatment.

Once the Committee has reviewed responses to this consultative document, and the results of the QIS, it intends to publish the final standard within an appropriate timeframe, and provide sufficient time for implementation, bearing in mind that the December 2014 revised securitisation framework is to be implemented by 2018.

## Annex 1

### Expanded set of STC criteria for regulatory capital purposes

This Annex provides suggested additional clarifications and enhancements to the BCBS-IOSCO July 2015 STC criteria (ie criteria A1 to C14 below). For certain criteria, the Annex contains guidance and clarification, together with a short rationale for why the Committee believes such clarifications are needed when using the criteria for regulatory capital purposes (ie for applying a different capital treatment to STC and other securitisations). In addition, the Committee has expanded the STC criteria with additional requirements (see Section D below – “Additional criteria for regulatory capital purposes”) that must be satisfied in order for a securitisation that satisfies the 14 STC criteria to receive alternative regulatory capital treatment.

#### A. Asset risk

##### A1. Nature of assets

In simple, transparent and comparable securitisations, the assets underlying the securitisation should be credit claims or receivables that are homogeneous. In assessing homogeneity, consideration should be given to asset type, jurisdiction, legal system and currency.

As more exotic asset classes require more complex and deeper analysis, credit claims or receivables should have contractually identified periodic payment streams relating to rental,<sup>8</sup> principal, interest, or principal and interest payments. Any referenced interest payments or discount rates should be based on commonly encountered market interest rates,<sup>9</sup> but should not reference complex or complicated formulae or exotic derivatives.<sup>10</sup>

#### Additional guidance for capital purposes

##### “Homogeneity”

The following auto loan examples can be used to interpret (for auto loans) and extrapolate (for other asset classes) what is meant by this term as it is used in A1.

Examples of a *homogeneous* auto loan pool would include, as of the securitisation closing date:

<sup>8</sup> Payments on operating and financing leases are typically considered to be rental payments rather than payments of principal and interest.

<sup>9</sup> Commonly encountered market interest rates may include rates reflective of a lender’s cost of funds, to the extent that sufficient data are provided to investors to allow them to assess their relation to other market rates.

<sup>10</sup> The Global Association of Risk Professionals (GARP) defines an exotic instrument as a financial asset or instrument with features making it more complex than simpler, plain vanilla, products.



- loans originated in the same currency;
- loans subject to the same legal framework for origination, transfer, and enforcement;
- loans that are retail instalment sale contracts secured by a mix of new and used cars, trucks and utility vehicles; and
- loans that have level monthly payments that fully amortise the amount financed over its original term, except that the payment in the first or last month during the life of the loan may be minimally different from the level payment.

Examples of a *non-homogeneous* auto loan pool would include:

- collateral mix of auto loans with fleet assets or rental car assets;
- collateral mix of auto loans with corporate/floorplan/dealer assets;
- collateral mix of auto loans with auto leases.

#### “Commonly encountered market interest rates”

Examples of these would include:

- interbank rates and rates set by monetary policy authorities, such as Libor, Euribor and the fed funds rate; and
- sectoral rates reflective of a lender’s cost of funds, such as internal interest rates that directly reflect the market costs of a bank’s funding or that of a subset of institutions.

#### “Exotic derivatives”

Interest rate caps and/or floors would not automatically be considered exotic derivatives.

### *Rationale*

The Committee considered that “homogeneity” in terms of asset types, legal system and currency is important and would be best exemplified through concrete examples. A similar approach is proposed for definitions of “commonly encountered market interest rates” and “exotic derivatives”.

#### **A2. Asset performance history**

In order to provide investors with sufficient information on an asset class to conduct appropriate due diligence and access to a sufficiently rich data set to enable a more accurate calculation of expected loss in different stress scenarios, verifiable loss performance data, such as delinquency and default data, should be available for credit claims and receivables with substantially similar risk characteristics to those being securitised, for a time period long enough to permit meaningful evaluation by investors. Sources of and access to data and the basis for claiming similarity to credit claims or receivables being securitised should be clearly disclosed to all market participants.

Additional consideration that is not part of the criterion<sup>11</sup>

In addition to the history of the asset class within a jurisdiction, investors should consider whether the originator, sponsor, servicer and other parties with a fiduciary responsibility to the securitisation have an established performance history for substantially similar credit claims or receivables to those being securitised and for an appropriately long period of time.

It is not the intention of the criteria to form an impediment to the entry of new participants to the market, but rather that investors should take into account the performance history of the asset class and the transaction parties when deciding whether to invest in a securitisation.

### Additional requirement for capital purposes

The originator/sponsor of the securitisation, as well as the original lender who underwrites the assets, should have sufficient experience in originating exposures similar to those securitised.

For capital purposes, investors must determine whether the performance history of the originator and the original lender for substantially similar claims or receivables to those being securitised has been established for an "appropriately long period of time". This performance history should ideally cover at least one complete economic cycle but must, in any case, be no shorter than a period of seven years for non-retail exposures. For retail exposures, the minimum performance history is five years.

### Rationale

The Committee considered that, in addition to the asset performance history, it is important that both the originator and the original lender should have a minimum track record in originating assets similar to those securitised, for example to avoid an originate-to-distribute model.

The Committee recommends making use of the IRB data requirements contained in paragraphs 472 and 473 to better define the term "appropriately long period of time". These data requirements would apply irrespective of the credit risk approach used to determine capital requirements on the underlying pool.

### A3. Payment status

Non-performing credit claims and receivables are likely to require more complex and heightened analysis. In order to ensure that only performing credit claims and receivables are assigned to a securitisation, credit claims or receivables being transferred to the securitisation may not, at the time of inclusion in the pool, include obligations that are in default or delinquent or obligations for which the transferor<sup>12</sup> or parties to the securitisation<sup>13</sup> are aware of evidence indicating a material increase in expected losses or of enforcement actions.

<sup>11</sup> This "additional consideration" may form part of investors' due diligence process, but does not form part of the criteria when determining whether a securitisation can be considered "simple, transparent and comparable".

<sup>12</sup> Eg the originator or sponsor.

<sup>13</sup> Eg the servicer or a party with a fiduciary responsibility.

## Additional guidance for capital purposes

Credit claims or receivables being transferred to the securitisation should not include obligations arising from credit-impaired borrowers. For capital purposes, a borrower will be deemed as credit-impaired where, to the best knowledge of the originator/sponsor of the securitisation, or the original lender who underwrites the assets:

- (a) the obligor has been the subject of an insolvency or debt restructuring process due to financial difficulties within three years prior to the date of origination; or,
- (b) the obligor is recorded on a public credit registry of persons with an adverse credit history, or on another credit registry, where a public one is not available in the jurisdiction; or,
- (c) the obligor has a credit assessment by an ECAI or a credit score indicating a significant risk of default.

Furthermore, credit claims or receivables being transferred to the securitisation may not be the subject of any dispute between the original lender and borrower on the underlying assets,<sup>14</sup> to the best knowledge of the originator, sponsor or original lender.

Additionally, at the time of their inclusion in the pool, at least one payment should have been made on the underlying exposures, except in the case of revolving asset trust structures such as those for credit card receivables, trade receivables, and dealer floor plan finance loans.

### *Rationale*

The Committee believes that providing a clear definition of credit-impaired borrowers should facilitate compliance checks.

#### **A4. Consistency of underwriting**

Investor analysis should be simpler and more straightforward where the securitisation is of credit claims or receivables that satisfy materially non-deteriorating origination standards. To ensure that the quality of the securitised credit claims and receivables is not affected by changes in underwriting standards, the originator should demonstrate to investors that any credit claims or receivables being transferred to the securitisation have been originated in the ordinary course of the originator's business to materially non-deteriorating underwriting standards. Where underwriting standards change, the originator should disclose the timing and purpose of such changes. Underwriting standards should not be less stringent than those applied to credit claims and receivables retained on the balance sheet.

These should be credit claims or receivables which have satisfied materially non-deteriorating underwriting criteria and for which the obligors have been assessed as having the ability and volition to make timely payments on obligations; or on granular pools of obligors originated in the ordinary course of the originator's business where expected cash flows have been modelled to meet stated obligations of the securitisation under prudently stressed loan loss scenarios.

<sup>14</sup> "Underlying assets" refers to the debt obligations (eg residential mortgage loan, auto loan), and not, for instance, to a car in an auto loan or a property in a residential mortgage loan.

## Additional requirement for capital purposes

In all circumstances, all credit claims or receivables should be originated in accordance with sound and prudent underwriting criteria based on an assessment that the obligor has the “ability and volition to make timely payments” on its obligations.

The originator/sponsor of the securitisation is expected, where underlying credit claims or receivables have been acquired from third parties, to review the underwriting standards (ie to check their existence and assess their quality) of these third parties and to ascertain that they have assessed the obligors’ “ability and volition to make timely payments on obligations”.

### *Rationale*

This additional condition improves the consistency of the criterion, as it requires securitised credit claims and receivables to be originated in accordance with sound and prudent underwriting standards in all circumstances, including for granular pools.

If the originator/sponsor of the securitisation did not originate the assets, the additional requirement will ensure that the originator has to check (a) the existence and quality of the standards; (b) that the borrowers to whom the acquired loans are extended have been screened by the lender, and (c) that their ability and their willingness to repay has been assessed by the original lender. This should not, however, be understood as an obligation for the originator to perform this assessment itself.

#### **A5. Asset selection and transfer**

Whilst recognising that credit claims or receivables transferred to a securitisation will be subject to defined criteria,<sup>15</sup> the performance of the securitisation should not rely upon the ongoing selection of assets through active management<sup>16</sup> on a discretionary basis of the securitisation’s underlying portfolio. Credit claims or receivables transferred to a securitisation should satisfy clearly defined eligibility criteria. Credit claims or receivables transferred to a securitisation after the closing date may not be actively selected, actively managed or otherwise cherry-picked on a discretionary basis. Investors should be able to assess the credit risk of the asset pool prior to their investment decisions.

In order to meet the principle of true sale, the securitisation should effect true sale such that the underlying credit claims or receivables:

- (a) are enforceable against the obligor and their enforceability is included in the representations and warranties of the securitisation;
- (b) are beyond the reach of the seller, its creditors or liquidators and are not subject to material re-characterisation or clawback risks;

<sup>15</sup> Eg the size of the obligation, the age of the borrower or the LTV (loan-to-value) of the property, DTI (debt-to-income) and/or DSC (debt service coverage) ratios.

<sup>16</sup> Provided they are not actively selected or otherwise cherry-picked on a discretionary basis, the addition of credit claims or receivables during the revolving periods or their substitution or repurchasing due to the breach of representations and warranties do not represent active portfolio management.

- (c) are not effected through credit default swaps, derivatives or guarantees, but by a transfer<sup>17</sup> of the credit claims or the receivables to the securitisation; and
- (d) demonstrate effective recourse to the ultimate obligation for the underlying credit claims or receivables and are not a securitisation of other securitisations.

In applicable jurisdictions, securitisations employing transfers of credit claims or receivables by other means should demonstrate the existence of material obstacles preventing true sale at issuance<sup>18</sup> and should clearly demonstrate the method of recourse to ultimate obligors.<sup>19</sup> In such jurisdictions, any conditions where the transfer of the credit claims or receivable is delayed or contingent upon specific events and any factors affecting timely perfection of claims by the securitisation should be clearly disclosed.

The originator should provide representations and warranties that the credit claims or receivables being transferred to the securitisation are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.

### Additional requirement for capital purposes

An independent third-party legal opinion should support the claim that the true sale and the transfer of assets under the applicable laws comply with points (a) through (d).

#### *Rationale*

A legal opinion would provide comfort that a transaction complies with these criteria, in particular, for cases where it is issued in accordance with non-domestic legal provisions. To avoid conflicts of interest, the legal opinion should be provided by an independent third party.

#### A6. Initial and ongoing data

To assist investors in conducting appropriate due diligence prior to investing in a new offering, sufficient loan-level data in accordance with applicable laws or, in the case of granular pools, summary stratification data on the relevant risk characteristics of the underlying pool should be available to potential investors before pricing of a securitisation.

To assist investors in conducting appropriate and ongoing monitoring of their investments' performance and so that investors that wish to purchase a securitisation in the secondary market have sufficient information to conduct appropriate due diligence, timely loan-level data in accordance with applicable laws or granular pool stratification data on the risk characteristics of the underlying pool and standardised investor reports should be readily available to current and potential investors at least quarterly throughout the life of the securitisation. Cut-off dates of the loan-level or granular pool stratification data should be aligned with those used for investor reporting.

<sup>17</sup> The requirement should not affect jurisdictions whose legal frameworks provide for a true sale with the same effects as described above, but by means other than a transfer of the credit claims or receivables.

<sup>18</sup> Eg the immediate realisation of transfer tax or the requirement to notify all obligors of the transfer.

<sup>19</sup> Eg equitable assignment, perfected contingent transfer.

To provide a level of assurance that the reporting of the underlying credit claims or receivables is accurate and that the underlying credit claims or receivables meet the eligibility requirements, the initial portfolio should be reviewed<sup>20</sup> for conformity with the eligibility requirements by an appropriate legally accountable and independent third party, such as an independent accounting practice or the calculation agent or management company for the securitisation.

*No additional language proposed.*

## B. Structural risk

### B7. Redemption cash flows

Liabilities subject to the refinancing risk of the underlying credit claims or receivables are likely to require more complex and heightened analysis. To help ensure that the underlying credit claims or receivables do not need to be refinanced over a short period of time, there should not be a reliance on the sale or refinancing of the underlying credit claims or receivables in order to repay the liabilities, unless the underlying pool of credit claims or receivables is sufficiently granular and has sufficiently distributed repayment profiles. Rights to receive income from the assets specified to support redemption payments should be considered as eligible credit claims or receivables in this regard.<sup>21</sup>

*No additional language proposed.*

### B8. Currency and interest rate asset and liability mismatches

To reduce the payment risk arising from the different interest rate and currency profiles of assets and liabilities and to improve investors' ability to model cash flows, interest rate and foreign currency risks should be appropriately mitigated<sup>22</sup> at all times, and if any hedging transaction is executed the transaction should be documented according to industry-standard master agreements. Only derivatives used for genuine hedging of asset and liability mismatches of interest rate and / or currency should be allowed.

## Additional requirement for capital purposes

The term "appropriately mitigated" should be understood as not necessarily requiring a completely perfect hedge. The appropriateness of the mitigation of interest rate and foreign currency through the life of the transaction must be demonstrated by making available to potential investors, in a timely and regular manner, quantitative information including the fraction of notional amounts that are hedged, as

<sup>20</sup> The review should confirm that the credit claims or receivables transferred to the securitisation meet the portfolio eligibility requirements. The review could, for example, be undertaken on a representative sample of the initial portfolio, with the application of a minimum confidence level. The verification report need not be provided but its results, including any material exceptions, should be disclosed in the initial offering documentation.

<sup>21</sup> For example, associated savings plans designed to repay principal at maturity.

<sup>22</sup> The term "appropriately mitigated" should be understood as not necessarily requiring a matching hedge. The appropriateness of hedging through the life of the transaction should be demonstrated and disclosed on a continuous basis to investors.

well as sensitivity analysis that illustrates the effectiveness of the hedge under extreme but plausible scenarios.

If hedges are not performed through derivatives, then those risk-mitigating measures are only permitted if they are specifically created and used for the purpose of hedging an individual and specific risk, and not multiple risks at the same time (such as credit and interest rate risks). Non-derivative risk mitigation measures must be fully funded and available at all times.

### *Rationale*

The Committee considered it necessary to clarify that “appropriately mitigated” should not necessarily be understood from an accounting point of view, but rather from an economic perspective.

#### **B9. Payment priorities and observability**

To prevent investors being subjected to unexpected repayment profiles during the life of a securitisation, the priorities of payments for all liabilities in all circumstances should be clearly defined at the time of securitisation and appropriate legal comfort regarding their enforceability should be provided.

To ensure that junior noteholders do not have inappropriate payment preference over senior noteholders that are due and payable, throughout the life of a securitisation, or, where there are multiple securitisations backed by the same pool of credit claims or receivables, throughout the life of the securitisation programme, junior liabilities should not have payment preference over senior liabilities which are due and payable. The securitisation should not be structured as a “reverse” cash flow waterfall such that junior liabilities are paid where due and payable senior liabilities have not been paid.

To help provide investors with full transparency over any changes to the cash flow waterfall, payment profile or priority of payments that might affect a securitisation, all triggers affecting the cash flow waterfall, payment profile or priority of payments of the securitisation should be clearly and fully disclosed both in offering documents and in investor reports, with information in the investor report that clearly identifies the breach status, the ability for the breach to be reversed and the consequences of the breach. Investor reports should contain information that allows investors to monitor the evolution over time of the indicators that are subject to triggers. Any triggers breached between payment dates should be disclosed to investors on a timely basis in accordance with the terms and conditions of all underlying transaction documents.

Securitisations featuring a revolving period should include provisions for appropriate early amortisation events and/or triggers of termination of the revolving period, including, notably: (i) deterioration in the credit quality of the underlying exposures; (ii) a failure to acquire sufficient new underlying exposures of similar credit quality; and (iii) the occurrence of an insolvency-related event with regard to the originator or the servicer.

Following the occurrence of a performance-related trigger, an event of default or an acceleration event, the securitisation positions should be repaid in accordance with a sequential amortisation priority of payments, in order of tranche seniority, and there should not be provisions requiring immediate liquidation of the underlying assets at market value.

To assist investors in their ability to appropriately model the cash flow waterfall of the securitisation, the originator or sponsor should make available to investors, both before pricing of the securitisation and on an ongoing basis, a liability cash flow model or information on the cash flow provisions allowing appropriate modelling of the securitisation cash flow waterfall.

To ensure that debt forgiveness, forbearance, payment holidays and other asset performance remedies can be clearly identified, policies and procedures, definitions, remedies and actions relating to delinquency, default or restructuring of underlying debtors should be provided in clear and consistent

terms, such that investors can clearly identify debt forgiveness, forbearance, payment holidays, restructuring and other asset performance remedies on an ongoing basis.

*No additional language proposed.*

#### **B10. Voting and enforcement rights**

To help ensure clarity for securitisation note holders of their rights and ability to control and enforce on the underlying credit claims or receivables, upon insolvency of the originator or sponsor, all voting and enforcement rights related to the credit claims or receivables should be transferred to the securitisation. Investors' rights in the securitisation should be clearly defined in all circumstances, including the rights of senior versus junior note holders.

*No additional language proposed.*

#### **B11. Documentation disclosure and legal review**

To help investors to fully understand the terms, conditions, legal and commercial information prior to investing in a new offering<sup>23</sup> and to ensure that this information is set out in a clear and effective manner for all programmes and offerings, sufficient initial offering<sup>24</sup> and draft underlying<sup>25</sup> documentation should be made available to investors (and readily available to potential investors on a continuous basis) within a reasonably sufficient period of time prior to pricing, or when legally permissible, such that the investor is provided with full disclosure of the legal and commercial information and comprehensive risk factors needed to make informed investment decisions. Final offering documents should be available from the closing date and all final underlying transaction documents shortly thereafter. These should be composed such that readers can readily find, understand and use relevant information.

To ensure that all the securitisation's underlying documentation has been subject to appropriate review prior to publication, the terms and documentation of the securitisation should be reviewed by an appropriately experienced third party legal practice, such as a legal counsel already instructed by one of the transaction parties, eg by the arranger or the trustee. Investors should be notified in a timely fashion of any changes in such documents that have an impact on the structural risks in the securitisation.

### **Additional guidance for capital purposes**

"Initial offering" should be understood to reference either:

- initial offering material made public as required for publicly registered/offered transactions, consistent with applicable laws and regulation, or;

<sup>23</sup> For the avoidance of doubt, any type of securitisation should be allowed to fulfil the requirements of Criterion 11 once it meets its prescribed standards of disclosure and legal review.

<sup>24</sup> Eg draft offering circular, draft offering memorandum, draft offering document or draft prospectus, such as a "red herring".

<sup>25</sup> Eg asset sale agreement, assignment, novation or transfer agreement; servicing, backup servicing, administration and cash management agreements; trust/management deed, security deed, agency agreement, account bank agreement, guaranteed investment contract, incorporated terms or master trust framework or master definitions agreement as applicable; any relevant inter-creditor agreements, swap or derivative documentation, subordinated loan agreements, start-up loan agreements and liquidity facility agreements; and any other relevant underlying documentation, including legal opinions.



- privately documented initial offering material (for non-publicly registered/offered transactions), provided that they contain essentially the same level of transparency and disclosure to investors as the initial offering material for publicly registered/offered transactions.

### *Rationale*

The Committee is clarifying that securitisation transactions can qualify as STC no matter what type of offering/registration or placement is applicable.

This would be possible provided that, in terms of transparency, transactions which are not required to make their (regulated) offering material public (under a public registration/offering regime) will document the initial offering material privately with the same level of transparency and disclosure as applicable in the case of a public registration/offering.

#### **B12. Alignment of interest**

In order to align the interests of those responsible for the underwriting of the credit claims or receivables with those of investors, the originator or sponsor of the credit claims or receivables should retain a material net economic exposure and demonstrate a financial incentive in the performance of these assets following their securitisation.

*No additional language proposed.*

## **C. Fiduciary and servicer risk**

#### **C13. Fiduciary and contractual responsibilities**

To help ensure servicers have extensive workout expertise, thorough legal and collateral knowledge and a proven track record in loss mitigation, such parties should be able to demonstrate expertise in the servicing of the underlying credit claims or receivables, supported by a management team with extensive industry experience. The servicer should at all times act in accordance with reasonable and prudent standards. Policies, procedures and risk management controls should be well documented and adhere to good market practices and relevant regulatory regimes. There should be strong systems and reporting capabilities in place.

The party or parties with fiduciary responsibility should act on a timely basis in the best interests of the securitisation note holders, and both the initial offering and all underlying documentation should contain provisions facilitating the timely resolution of conflicts between different classes of note holders by the trustees, to the extent permitted by applicable law.

The party or parties with fiduciary responsibility to the securitisation and to investors should be able to demonstrate sufficient skills and resources to comply with their duties of care in the administration of the securitisation vehicle.

To increase the likelihood that those identified as having a fiduciary responsibility towards investors as well as the servicer execute their duties in full on a timely basis, remuneration should be such that these parties are incentivised and able to meet their responsibilities in full and on a timely basis.

## Additional guidance for capital purposes

In assessing whether “strong systems and reporting capabilities are in place”, well documented policies, procedures and risk management controls, as well as strong systems and reporting capabilities, may be substantiated by a third-party review for non-banking entities.

### *Rationale*

Banks are subject to an ongoing assessment of their internal reporting systems and capabilities, as outlined in Criterion 7 of Principle 15 of the Basel Core Principles for Effective Banking Supervision. To ensure an assessment that is comparable with that of banking entities, other non-bank originating entities not subject to the Basel Core Principles should provide proof of an independent assessment of their reporting capabilities. Evidence of a suitable third-party review can be based on the supervisory regime applicable to this entity (if such supervision covers internal reporting systems).

#### **C14. Transparency to investors**

To help provide full transparency to investors, assist investors in the conduct of their due diligence and to prevent investors being subject to unexpected disruptions in cash flow collections and servicing, the contractual obligations, duties and responsibilities of all key parties to the securitisation, both those with a fiduciary responsibility and of the ancillary service providers, should be defined clearly both in the initial offering and all underlying documentation. Provisions should be documented for the replacement of servicers, bank account providers, derivatives counterparties and liquidity providers in the event of failure or non-performance or insolvency or other deterioration of creditworthiness of any such counterparty to the securitisation.

To enhance transparency and visibility over all receipts, payments and ledger entries at all times, the performance reports to investors should distinguish and report the securitisation’s income and disbursements, such as scheduled principal, redemption principal, scheduled interest, prepaid principal, past due interest and fees and charges, delinquent, defaulted and restructured amounts under debt forgiveness and payment holidays, including accurate accounting for amounts attributable to principal and interest deficiency ledgers.

## Additional guidance for capital purposes

The term “income and disbursements” should also be understood as including deferment, forbearance, and repurchases among the items described.

### *Rationale*

Certain asset classes, such as US student loans, are an example of an asset class that utilises deferment and forbearance as categories to describe the status of student loans, in addition to reporting a pool’s standard ageing and delinquency.

## D. Additional criteria for capital purposes

### D15. Credit risk of underlying exposures

At the portfolio cut-off date the underlying exposures have to meet the conditions under the Standardised Approach for credit risk, and after taking into account any eligible credit risk mitigation, for being assigned a risk weight equal to or smaller than:

- [40%] on a value-weighted average exposure basis for the portfolio (before the application of the credit risk mitigation) where the exposures are loans secured by residential mortgages or fully guaranteed residential loans;
- [50%] on an individual exposure basis where the exposure is a loan secured by a commercial mortgage;
- [75%] on an individual exposure basis where the exposure is a retail exposure; or
- [100%] on an individual exposure basis for any other exposure.

### *Rationale*

The Committee was concerned that the absence of consistent underwriting practices across jurisdictions could result in different risk characteristics within a single asset class. A criterion based on regulatory risk weights under the Standardised Approach has the merit of using globally consistent regulatory risk measures. It also provides the benefit of applying a filter to ensure higher-risk underlying exposures are not granted an alternative capital treatment as STC-compliant transactions. Careful consideration is needed on whether the risk weight requirement should be applied on individual exposures or on a portfolio-weighted average basis.

Additionally, it should be noted that the draft risk weights included are based on the current Standardised Approach. The exact risk-weight cut-offs to be used will need to be revisited once the ongoing revisions to the Standardised Approach for credit risk are finalised.

### D16. Granularity of the pool

At the portfolio cut-off date, the aggregated value of all exposures to a single obligor should not exceed 1% of the aggregated outstanding exposure value of all exposures in the portfolio.

### *Rationale*

The Committee proposes providing a concrete definition of granularity to help ensure that granular asset portfolios would be at a level where statistical approaches to model losses can be employed, as opposed to having to review the credit quality of individual exposures.

### D17. Relationship between the originator and the servicer of the securitised assets

Except for residential mortgages in a jurisdiction where it is common practice to employ a third party servicer, the servicer of the assets and the originator of the assets should either be the same legal entity or affiliates with a common parent entity. In regards to residential mortgages in a jurisdiction where it is common practice to employ a third party servicer, such servicer should be widely recognised in the industry for its residential mortgage servicing excellence.

## *Rationale*

The Committee proposes tying the originator and the servicer together because these structures tend to be the simplest, most comparable and most transparent, regardless of asset class. Further, when the servicer and originator are related parties, they have an incentive to ensure that the securitisation performs as expected because these entities tend to engage regularly in securitisation activity. If a securitisation does not perform as expected, it may be difficult for the entity to continue to access the securitisation market with the same overall level of execution (eg credit support, pricing, size of issuance, investor interest). The originator (or an affiliate) also tends to be the holder of the first loss in the securitisation, so the performance goals of the servicer and originator are generally aligned with those of investors.

## Annex 2

### Standards text added to the December 2014 securitisation framework on treatment of STC securitisations

#### Scope and identification of STC securitisations for the purposes of the alternative capital treatment

109. Only non-ABCP, traditional securitisations are within the scope of the STC framework. Non-ABCP, true sale securitisations that are STC-compliant will be subject to capital requirements as determined by paragraphs [115 to 118].

110. For regulatory capital purposes, a securitisation transaction falling within the scope of this section will be considered STC-compliant provided that it meets [all the criteria in Annex 1 of this consultative document], ie the July 2015 STC criteria published by the Committee and IOSCO (Criteria A1 to C14) together with the requirements and guidance added by the Committee in this consultative document, and the additional requirements proposed by the Committee in this consultation (Criteria D15 to D17).

#### Compliance with the STC criteria and the additional criteria for capital purpose and oversight

111. The originator/sponsor must make a determination at transaction level on the STC criteria, and attest whether a securitisation is STC-compliant as defined in paragraph [110]. In addition, the investor must also make its own assessment of the securitisation's STC compliance status.

For retained positions where the originator has achieved significant risk transfer in accordance with paragraphs [25] or [26], the determination shall be made only by the originator retaining the position.

112. STC criteria need to be met at all times. Checking the compliance with some of the criteria might only be necessary at origination (or at the time of initiating the exposure, in case of guarantees or liquidity facilities) to an STC securitisation. Notwithstanding, investors and holders of the securitisation positions are expected to take into account developments that may invalidate the previous compliance assessment, for example deficiencies in the frequency and content of the investor reports, in the alignment of interest, or changes in the transaction documentation at variance with relevant STC criteria.

In cases where the criteria refer to underlying assets – including, but not limited to Criteria D 15 and 16 - and the pool is dynamic, the compliance with the criteria will be subject to dynamic checks every time that assets are added to the pool.

## Alternative capital treatment for STC securitisations meeting the additional criteria for capital purposes

113. Securitisation transactions that are assessed as STC-compliant for capital purposes as defined in paragraph [110] shall be subject to capital requirements under the securitisation framework, taking into account that:

- When the SEC-IRBA is used, paragraphs [114] and [115] are applicable instead of paragraphs [56] and [64] respectively;
- When the SEC-ERBA is used, paragraphs [114], [116] and [117] are applicable instead of paragraphs [66], [68] and [70] respectively;
- When the SEC-SA is used, paragraphs [114] and [118] are applicable instead of paragraphs [85] and [87] respectively.

114. Under all three approaches, the resulting risk weight is subject to a floor risk weight [in the range between (10% and 12%)] for senior tranches, and 15% for non-senior tranches.

### SEC-IRBA

115. The supervisory parameter  $p$  in SEC-IRBA for an exposure to an STC securitisation is as follows:

$$p = \max [0.3; (A + B*(1/N) + C*K_{IRB} + D*LGD + E*M_T)*x],$$

where:

- $x$  is in the range between 0.6 to 0.8;
- 0.3 denotes the  $p$ -parameter floor;
- $N$  is the effective number of loans in the underlying pool, calculated as described in paragraph [59];
- $K_{IRB}$  is the capital charge of the underlying pool (as defined in paragraph [49]);
- $LGD$  is the exposure-weighted average loss-given-default of the underlying pool, calculated as described in paragraph [60];
- $M_T$  is the maturity of the tranche calculated according to paragraphs [22 and 23]; and
- the parameters  $A$ ,  $B$ ,  $C$ ,  $D$ , and  $E$  are determined according to the following look-up table:

		<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>
<b>Wholesale</b>	<b>Senior</b> , granular ( $N \geq 25$ )	0	3.56	-1.85	0.55	0.07
	<b>Senior</b> , non-granular ( $N < 25$ )	0.11	2.61	-2.91	0.68	0.07
	<b>Non-senior</b> , granular ( $N \geq 25$ )	0.16	2.87	-1.03	0.21	0.07
	<b>Non-senior</b> , non-granular ( $N < 25$ )	0.22	2.35	-2.46	0.48	0.07
<b>Retail</b>	<b>Senior</b>	0	0	-7.48	0.71	0.24
	<b>Non-senior</b>	0	0	-5.78	0.55	0.27

### SEC-ERBA

116. For exposures with short-term ratings, or when an inferred rating based on a short-term rating is available, the following risk weights will apply:

Table 1: ERBA risk weights for short-term ratings

External credit assessment	A-1/P-1	A-2/P-2	A-3/P-3	All other ratings
Risk weight	[10%]	[35%]	[80%]	[1,250%]

117. For exposures with long-term ratings, risk weights will be determined according to Table 2 and will be adjusted for tranche maturity (calculated according to paragraphs [22 and 23]), and tranche thickness for non-senior tranches according to paragraph [69].

Table 2: ERBA risk weights for long-term ratings (NB: risk weight ranges shown in brackets, depending on final calibration for risk weight floor and p-factor)

Rating	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity ( $M_T$ )		Tranche maturity ( $M_T$ )	
	1 year	5 years	1 year	5 years
AAA	[10% - 12]	15%	15%	[45% - 55%]
AA+	[10% - 12%]	[20% - 25%]	15%	[60% - 40%]
AA	[15% - 20%]	[25% - 30%]	[20% - 25%]	[75% - 95%]
AA-	[20% - 25%]	[30% - 35%]	[25% - 30%]	[90% - 110%]
A+	[30% - 35%]	[35% - 40%]	[40% - 50%]	[110% - 135%]
A	[35% - 40%]	[45% - 55%]	[55% - 65%]	[125% - 150%]
A-	[40% - 50%]	[50% - 60%]	[85% - 100%]	[150% - 175%]
BBB+	[60% - 65%]	[70% - 80%]	[135% - 155%]	[205% - 235%]
BBB	[70% - 80%]	[80% - 95%]	[175% - 200%]	[245% - 280%]
BBB-	[95% - 110%]	[110% - 125%]	[260% - 300%]	[330% - 380%]
BB+	[115% - 130%]	[130% - 145%]	[390% - 435%]	[480% - 535%]
BB	[130% - 145%]	[150% - 165%]	[515% - 575%]	[630% - 700%]
BB-	[165% - 185%]	[185% - 210%]	[620% - 695%]	[710% - 795%]
B+	[220% - 235%]	[245% - 260%]	[785% - 845%]	[830% - 890%]
B	[270% - 290%]	[295% - 320%]	[920% - 985%]	[920% - 985%]
B-	[330% - 355%]	[365% - 395%]	[990% - 1,060%]	[990% - 1,060%]
CCC+/CCC/CCC-	[410% - 435%]	[450% - 480%]	1,250%	1,250%
Below CCC-	1,250%	1,250%	1,250%	1,250%

## SEC-SA

118. The supervisory parameter p in the context of the SEC-SA is set equal to [0.6-0.8] for an exposure to an STC securitisation.