Basel Committee
on Banking Supervision

Technical amendment

Capital treatment of securitisations of non-performing loans

November 2020

BANK FOR INTERNATIONAL SETTLEMENTS

This publication is available on the BIS website (www.bis.org).

ISBN 978-92-9259-439-8 (online)

Contents

Capital treatment of securitisations of non-performing loans

Introduction

To promote a consistent global implementation of the Basel framework, the Committee regularly monitors and reviews issues that arise from the implementation of its standards. Where necessary, it publishes clarifications and interpretative guidance. In some instances, these issues can be clarified in the form of answers to frequently asked questions (FAQs), without any changes to the standard. On other occasions, the issue, though minor in effect, cannot be resolved unambiguously without an amendment of the text of the standard itself. In these cases, the Committee publishes the clarification as a proposed technical amendment, open for consultation during a short period of typically 45 days.

The following rules text is related to the capital treatment of securitisations of non-performing loans. The Committee consulted on this amendment in June 2020 for a period of 60 days[1] and is thankful to all respondents to the consultative document.

Technical amendment to the securitisation standard

This technical amendment, which the Committee started developing before the onset of the Covid-19 pandemic, addresses a gap in the regulatory framework and sets out a prudent treatment for securitisations of non-performing loans. These transactions are subject to different risk drivers compared to securitisations of performing assets. Consistent with this, recent observations in which the securitised portfolio consists mostly of non-performing loans have shed light on potential risk weight miscalibration.

To correct this situation, the Committee agreed to add the following elements to the securitisation standard in the Basel Framework,[2] to be implemented by no later than 1 January 2023:

- An explicit definition of securitisations of non-performing loans.
- Removal of the option to use foundation internal risk-based parameters as inputs for the internal ratings-based approach (SEC-IRBA) for all securitisations of non-performing loans.
- Introduction of a 100% risk weight floor for exposures to securitisations of non-performing loans that are risk weighted under the SEC-IRBA or the standardised approach (SEC-SA).
- For the senior tranches of securitisations of non-performing loans where the non-refundable purchase price discount is equal to, or greater than, 50% of the securitised portfolio, the risk weight under SEC-IRBA or SEC-SA is 100%.

All other provisions of the current securitisation standard, including the use of external ratings-based approach (SEC-ERBA) and the possibility of capping the capital requirement for exposures from the same transaction, will also apply to securitisations of non-performing loans. This technical amendment does not change any rule related to securitisations of performing loans.

[1] *Capital treatment of securitisations of non-performing loans*, Basel Committee on Banking Supervision. June 2020. Available at: https://www.bis.org/bcbs/publ/d504.htm

[2] The consolidated Basel Framework is available at: https://www.bis.org/basel_framework/.

Annex

The capital treatment for securitisations of non-performing loans described in this document will be incorporated into the Basel Framework by amending paragraph CRE40.48 and by adding a new chapter CRE45. These rules should be implemented by member jurisdictions by no later than 1 January 2023. The parts in red are the new additions to the Basel Framework.

CRE40. Securitisation: general provisions

(...)

40.48 For resecuritisation exposures, banks must apply the SEC-SA, with the adjustments in CRE41.16. For exposures to securitisations of non-performing loans as defined in CRE45.1, banks must apply the framework with the adjustments laid out in CRE45.

(...)

CRE45. Securitisations of non-performing loans

45.1 A non-performing loan securitisation (NPL securitisation) means a securitisation where the underlying pool's variable W, as defined in CRE41.6, is equal to or higher than 90% at the origination cut-off date and at any subsequent date on which assets are added to or removed from the underlying pool due to replenishment, restructuring or any other relevant reason. The underlying pool of exposures of an NPL securitisation may only comprise loans, loan-equivalent financial instruments or tradable instruments used for the sole purpose of loan subparticipation as referred to in CRE40.24(2). Loan-equivalent financial instruments include, for example, bonds not listed on a trading venue. For the avoidance of doubt, an NPL securitisation may not be backed by exposures to other securitisations.

45.2 National supervisors may provide for a stricter definition of NPL securitisations than that laid out in CRE45.1. For these purposes, national supervisors may:

(1) raise the minimum level of W to a level higher than 90%; or

(2) require that the non-delinquent exposures in the underlying pool comply with a set of minimum criteria, or preclude certain types of non-delinquent exposures from forming part of the underlying pools of NPL securitisations.

Without prejudice to the foregoing, national supervisors should scrutinise NPL securitisations to prevent any instances of regulatory arbitrage. In particular, national supervisors should preclude transactions executed with the main purpose of reducing the capital charge on the non-delinquent exposures in the underlying relative to the 100% risk weight on the senior exposure to the NPL securitisation referred to in CRE45.5.

45.3 A bank is precluded from applying the SEC-IRBA to an exposure to an NPL securitisation where the bank uses the foundation approach as referred to in CRE30.35 to calculate the K_{IRB} of the underlying pool of exposures.

45.4 The risk weight applicable to exposures to NPL securitisations according to SEC-IRBA (CRE44), SEC-SA (CRE41) or the look-through approach in CRE40.50 is floored at 100%.

45.5 Where, according to the hierarchy of approaches in CRE40.41 to CRE40.47, the bank must use the SEC-IRBA or the SEC-SA, a bank may apply a risk weight of 100% to the senior tranche of an NPL securitisation provided that the NPL securitisation is a traditional securitisation and the sum of the non-refundable purchase price discounts (NRPPD), calculated as described in CRE45.6, is equal to or higher than 50% of the outstanding balance of the pool of exposures.

45.6 For the purposes of CRE45.5, NRPPD is the difference between the outstanding balance of the exposures in the underlying pool and the price at which these exposures are sold by the originator to the securitisation entity, when neither originator nor the original lender are reimbursed for this difference. In cases where the originator underwrites tranches of the NPL securitisation for subsequent sale, the NRPPD may include the differences between the nominal amount of the tranches and the price at which these tranches are first sold to unrelated third parties. For any given piece of a securitisation tranche, only its initial sale from the originator to investors is taken into account in the determination of NRPPD. The purchase prices of subsequent re-sales are not considered.

45.7 An originator or sponsor bank may apply the capital requirement cap specified in paragraph CRE40.54 to the aggregated capital requirement for its exposures to the same NPL securitisation. The same applies to an investor bank, provided that it is using the SEC-IRBA for an exposure to the NPL securitisation.