

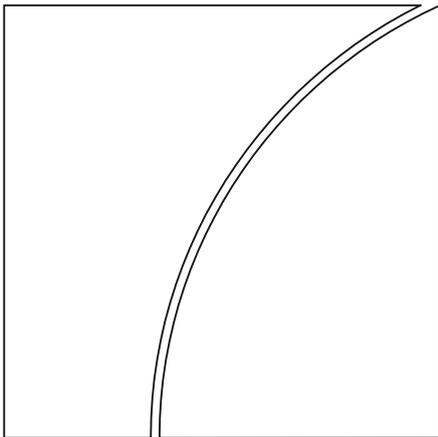
Basel Committee on Banking Supervision

Technical amendment

Capital treatment of securitisations of non- performing loans

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Contents

Introduction..... 1

Technical amendment to the securitisation standard 1

Annex 3

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, implementation issues can be clarified in the form of answers to frequently asked questions (FAQs), without any change to the standard. On other occasions, the issue cannot be resolved unambiguously without an amendment to the text of the standard itself. In these cases, the Committee has decided to publish the clarification as a proposed technical amendment. Such amendments will be published for a short consultation period, typically for 45 calendar days. The current amendment is open for comments for 60 days.

The following technical amendment to the securitisation rules text is related to the capital treatment of securitisations of non-performing loans. The Committee is of the view that securitisations of non-performing loans are subject to different risk drivers compared to securitisations of performing assets, which points to a need for a specific treatment to reflect these differences in a risk-sensitive and conservative way.

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. The Committee invites comments on the proposed amendment by 23 August 2020.

Technical amendment to the securitisation standard

Securitisations of non-performing loans have particular features that distinguish them from securitisations of performing assets. These differences have consequential implications for the calibration of risk weights in the securitisation framework. The current Basel Committee securitisation standard was designed and calibrated using a range of securitisation transactions, all of which involved performing assets, reflecting the predominance of such securitisations in the market. Recent observations on securitisations in which the securitised portfolio consists mostly of non-performing loans have since shed light on potential mis-calibration of the risk weights applicable to these transactions under the Basel III securitisation framework.¹

Thus, the Committee is proposing a technical amendment to the securitisation standard to implement the following modifications, without changing any of the existing rules for securitisations of performing assets:

- Establishment of a standardised definition of NPL securitisations as securitisation transactions where there is a percentage of at least 90% of defaulted assets in the portfolio at inception and at a later time where assets are added to or removed from the underlying pool due to replenishment, restructuring or any other relevant reason. Re-securitisations are expressly excluded from this definition of NPL securitisations. The definition above is a minimum standard, and national supervisors should be able to implement stricter criteria, in particular with the prevailing objective of preventing regulatory arbitrage.

¹ The Committee notes that the securitisation framework is intended to be applied to the tranching of credit risk associated with financial exposures such as loans, commitments, asset-backed and mortgage-backed securities, corporate bonds, equity securities, and private equity investments (see CRE40.6). Some transactions involving cash flows from real estate might alternatively be capitalised under other sections of the credit risk framework, if warranted (see CRE40.1). Banks are encouraged to consult with their national supervisors when there is uncertainty about whether a given transaction should be considered a securitisation.

- A ban on the use of foundation IRB parameters as inputs for the SEC-IRBA for all NPL securitisations.
- Introduction of a risk weight floor of 100% for all NPL securitisation exposures.
- Introduction of a fixed 100% risk weight applicable to the most senior tranche of qualifying NPL securitisations, where “qualifying” refers to traditional securitisations in which the non-refundable purchase price discount (NRPPD), which is essentially the discount applied to the nominal or outstanding value of the NPL portfolio when these defaulted assets are securitised, is equal to or larger than 50% of the outstanding amount of the NPLs;
- In conjunction with the foundation IRB parameters ban and the 100% risk weight floor, the current provisions of the securitisation framework continue to apply to all other exposures to NPL securitisations (ie senior tranches of non-qualifying NPL securitisations, and mezzanine and junior tranches of all NPL securitisations); and
- Those banks that are allowed, under the current rules, to apply a maximum capital requirement for their securitisation exposures in the same transaction can continue to apply the same maximum capital requirement as applicable under current rules. This applies to originator and sponsor banks as well as investor banks using the SEC-IRBA.

Proposed modifications to the Basel Framework are presented in the Annex. The Committee proposes that this amendment to the securitisation standard will come into effect by no later than 1 January 2023.

Annex

The Committee proposes to incorporate the capital treatment for securitisations of non-performing loans described in this document by amending paragraph CRE40.48 and by adding a new Chapter CRE45 to the Basel framework. The Committee proposes that this treatment should be implemented by member jurisdictions by no later than 1 January 2023. The parts in red are proposed new additions to the currently existing rules text.

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, banks must apply the risk weights according to 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 CRE 40.24(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 CRE 45.1. 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 CRE45.3.

45.3 A bank should assign a fixed 100% risk weight to the senior tranche of NPL securitisations instead of applying the hierarchy of approaches referred to in CRE40.41

to CRE40.47 and the look-through approach referred to in CRE40.50 when the following three conditions are met:

- (1) the NPL securitisation is a traditional securitisation;
- (2) the underlying pool of exposures was securitised at a discounted price on the outstanding amount of the pool of exposures and the discount is not refundable to the originator or original lender (the non-refundable purchase price discount or NRPPD); and
- (3) the NRPPD referred to in (2) was equal to or higher than 50% of the outstanding amount of the pool of exposures as of the origination cut-off date;

45.4 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 CRE30.33 to calculate the K_{IRB} of the underlying pool of exposures.

45.5 In all other cases, banks must follow the hierarchy of approaches referred to in CRE40.41 to CRE40.47 or the look-through approach referred to in CRE40.50. However, where an exposure to an NPL securitisation may be assigned a risk weight of less than 100% in accordance with these approaches, a risk weight floor of 100% should instead be used for that exposure.

45.6 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.