

EBA/Op/2015/14

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07 July 2015

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# Opinion of the European Banking Authority on a European framework for qualifying securitisation

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## Introduction and legal basis

The EBA competence to deliver this Opinion to the European Commission is based on Article 34(1) of Regulation (EU) No 1093/2010<sup>1</sup>.

In January 2014 the EBA received a call for advice from the Commission inviting the EBA to identify which characteristics would be the most appropriate to designate 'high-quality' transactions, having particular regard to:

- Categories of underlying assets;
- Structural features;
- Transparency features.

EBA was also invited to assess the appropriateness, from a prudential perspective, of granting future preferential treatment to certain securitisation transactions qualified as 'high quality' transactions in order to foster EU securitisation markets and, where the EBA concluded that such merit exists, to identify the concrete measures and reasons substantiating the preferential treatment to be granted to these securitisation transactions in the area of capital requirements.

In accordance with Article 14(5) of the Rules of Procedure of the Board of Supervisors<sup>2</sup>, the Board of Supervisors has adopted this opinion.

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<sup>1</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

<sup>2</sup> Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 27 November 2014 (Decision EBA DC 001 (Rev4)).

## General Comments

This Opinion constitutes the advice of the EBA on several aspects related to the establishment of a European framework for qualifying securitisation.

The 'EBA Report on qualifying securitisation' (the Report), accompanying this Opinion, develops the analysis which was carried out and which resulted in the different recommendations.

The advice takes the form of one more general proposal and a series of more specific proposals contained in the next section. Thus, in terms of the more general proposal:

### SPECIAL CONSIDERATIONS

*It should be noted that the recommendations provided in the report in relation to the implementation of a qualifying securitisation framework in Europe will have to be revisited depending on the progress and decisions taken by the Basel and IOSCO Committees on the definition of a simple transparent and comparable securitisations framework, at the global level, and the re-calibration of the BCBS 2014 securitisation framework to provide regulatory recognition to STC securitisations.*

*In particular:*

- *The criteria proposed in the report for the definition of qualifying securitisations may have to be amended based on the final STC framework adopted at the global level.*
- *The parameter values chosen within the re-calibration proposals put forward in the report may have to be changed if global standard setters choose to implement equivalent re-calibration proposals. The parameters proposed in the report result from empirical analysis and QIS analysis carried out, for the most part, on European securitisation transactions and, as such, may be substantially different from the numbers that would result from a global application of the analysis.*

## Specific Proposals

- A recommendation for a holistic (cross-product and sector) review of the regulatory framework for securitisations and other investment products:

**RECOMMENDATION 1: Recommendation for a holistic (cross-product and sector) review of the regulatory framework for securitisations and other investment products. Following the review, action should be taken where appropriate.**

*A systemic detailed review of the entire regulatory framework for securitisation across all different regulations and regulatory authorities on a stand-alone basis and in conjunction with the regulatory framework applicable to other investment products (covered bonds, whole loan portfolios) is recommended. Such a review should take into account the different objectives of the existing regulations.*

### Rationale

Since the crisis, many regulations have been introduced at international and EU level to address the shortcomings of the securitisation market and many more are still being proposed and finalised. Limited changes have been introduced or proposed to other investment products.

The risk exists that the extent of some of the differences between the regulatory treatment of securitisation and other investment instruments may not be fully justified when being compared on a single requirement basis or on an aggregate basis considering all features of and requirements for the respective investment products.

Major differences in regulatory treatment clearly have an impact on the incentives to issue or invest in one instrument or the other and may lead to unintentional effects that could destabilise the financial system as a whole. Possible unintended consequences could include: i) changes in business models of institutions to optimise regulatory capital usage, ii) increased use of the shadow banking system for funding, iii) an increased level of asset-encumbrance for credit institutions and iv) over-reliance on, and substantial exposures to, one investment product only.

With the increasing complexity of the regulatory framework investors, or example insurance companies, managers of UCITS or AIFs, banks or other regulated investors need to consider many different regulatory factors, including:

- i) regulatory capital charges;
- ii) liquidity regulation;
- iii) operational requirements (retention, retaining entity, disclosure, due diligence including stress testing, reporting).

Each of these requirements implies both costs and benefits that investors and issuers, as appropriate, take into account when making decisions to invest or issue securitisations.

- A recommendation on the overall approach to defining ‘qualifying’ securitisations, in accordance with a two-stage logic:

### **RECOMMENDATION 2: Recommendation to create a framework for ‘qualifying’ securitisations**

A ‘qualifying’ securitisation framework should be defined in accordance with what can be called a two-stage approach, as follows:

- a. **Stage 1 – simple standard and transparent securitisations (SST) should be identified:** *Criteria defining SST securitisation processes/structures should ensure that the securitisation process does not add ‘excessive’ additional risk and complexity on top of the credit risk of the assets being securitised: this process should be fully transparent to investors, should not embed excessive leverage, should not engage in excessive maturity transformation and should provide all the entities involved with the right incentives, not to replicate the so called ‘originate-*

*to-distribute' model observed in the run-up to the crisis.*

- b. ***Stage 2 – SST 'qualifying' for lower capital requirements:*** *Criteria aimed at limiting the credit risk of the exposures to be securitised should be fulfilled, in addition to the requirements of the SST framework, in order to consider a given securitisation instrument qualifying for a differentiated (lower) capital treatment. Credit risk criteria on the underlying exposures are needed to prevent very risky/volatile assets (e.g. sub-prime mortgage loans) from entering an SST securitisation structure. Risky/volatile assets could sensibly increase the uncertainty and margin of error of the credit tranching and repackaging process, resulting in overall riskier securitisation investments.*

*Figure 15 in the report, summarises the proposed two-stage approach to qualifying securitisation.*

#### Rationale

Simple, standard and transparent securitisations should:

- i) raise the minimum standards for securitisations transactions and lead to more standardised products and harmonised practices in the securitisation market;
- ii) contribute to the re-establishment of investors' confidence in the securitisation instrument and, potentially, contribute to broadening the investor base for securitisations;
- iii) pave the way to a more risk-sensitive regulatory framework that can differentiate between different securitisation products with different risks and historical performance.

Qualifying securitisations, recognised within the regulatory capital framework, will enhance the sensitivity of capital requirements applicable to securitisation positions and will maintain a risk-based regulatory playing field for securitisation products vis-à-vis comparable financial instruments.

In addition, a two-stage approach to defining qualifying securitisations lends itself to extending the 'qualifying' concept to chapters of prudential regulation other than bank capital requirements. The first stage of the framework, i.e. the identification of SST securitisations, could in fact easily form the basis for a common definition across regulatory chapters on securitisation, ranging from bank capital requirements to banks' liquidity requirements and insurance companies' capital requirements and, where necessary, other regulations. The second stage which, in the case of bank capital regulation, takes the form of credit risk criteria on the underlying exposures, could instead include different sector-specific requirements needed to determine eligibility for a 'qualifying' regulatory treatment related to the type of prudential regulation under consideration, i.e. liquidity regulation, insurance capital regulation, etc.

Such a cross-sectoral implementation of the SST criteria and the two-stage approach should be taken into consideration in order to simplify and streamline the regulatory treatment of securitisations across prudential regulations.

- A recommendation on the specific criteria (illustrated in the report accompanying this opinion) that shall define qualifying term securitisation:

### **RECOMMENDATION 3: Recommendation on criteria defining ‘qualifying’ term securitisations**

*Simple, Standard and Transparent (SST) term securitisations should be defined by means of criteria as defined under pillars I, II and III in section 5.3 of the report.*

*Minimum credit quality of underlying exposures within ‘qualifying’ term securitisation transactions should be defined by means of criteria as defined under Stage 2 in section 5.3 of the report.*

*The criteria proposed in the report apply to traditional term securitisations; synthetic term securitisations, while meeting the CRR definition of securitisation, are out of the scope of the criteria proposed in the report as features of simplicity, standardisation and transparency of such instruments cannot be appropriately considered on the basis of the criteria applicable to traditional securitisations.*

*In the context of Criterion 7 (Pillar II, below) it is considered essential that the effectiveness of EU retention rules, particularly with respect to issues related to the definition of ‘originator’, be re-considered in line with the EBA advice on EU retention rules included in the EBA report published in December 2014.*

*It should be noted that the maximum risk weight requirements proposed under Stage 2 on the credit quality of the underlying exposures are based on the currently applicable standardised approach to credit risk provided for in the CRR; these requirements should be reviewed as the Basel reform of the standardised approach is finalised and implemented.*

#### Rationale

SST criteria capture and reduce the major non-credit related risks of a securitisation that were identified during the crisis including i) the use of an ‘originate to distribute’ model, ii) the recourse to leverage, iii) the exposure of investors to substantial refinancing risk and iv) the lack of transparency.

The proposed three pillars ensure many safeguards, including but not limited to retention of economic interest, enforceable legal and economic transfer of the underlying exposures, simple payment waterfall structures, limited re-financing risk and liquidation risk, disclosure of data on underlying exposures at a loan-by-loan level, as well as disclosure to investors of underlying transaction documentation and quarterly reporting.

Identifying securitisation with these characteristics should, as a minimum, enhance investor confidence in the securitisation products and contrast the crisis stigma which the market has attracted. In addition, it should ensure that a sufficiently broad investor base is able to carry out, with confidence, the necessary due diligence assessments and risk modelling analysis.

In order to ensure that the pool of underlying exposures meets standards of minimum credit quality it is necessary to make sure that: i) the loans from which the exposures arise are

underwritten in accordance with standards recognised by EU prudential regulation as prudent; ii) the pool of underlying exposures itself is not characterised by excessive concentration, whereby the credit quality of the exposures towards a specific obligor would drive the credit quality of the whole pool of exposures exposing the securitisation investment to excessive idiosyncratic risk; iii) the maximum riskiness of each underlying exposure is capped through the backstop measure of the maximum risk weight. The latter is important to ensure the minimum credit quality of all underlying exposures under all those aspects that cannot be captured by underwriting standards. It is particularly relevant for those types of underlying exposures whose underwriting process is less regulated and standardised and hence more difficult to control by means of qualitative criteria.

- A recommendation on the specific criteria (illustrated in the report accompanying this opinion) that shall define qualifying ABCP securitisation:

**RECOMMENDATION 4: Recommendation on criteria defining ‘qualifying’ ABCP securitisations**

*‘Qualifying’ ABCP securitisations should be defined by means of the criteria presented in section 5.6.1 of the report.*

*‘Qualifying’ ABCP programmes should be defined by means of the criteria presented in section 5.6.2 of the report.*

Rationale

Securitisation in the context of ABCP programmes has many common features with term securitisation, which justifies using a two-stage approach based on very similar regulatory criteria. However, the ‘qualifying’ framework for securitisations in the context of ABCP programmes should recognise many specific characteristics of the ABCP segment, including:

- the possibility of becoming exposed to an ABCP securitisation either at the transaction level or at the programme level, for which different sets of requirements ought to be envisaged;
- the existence of multi-seller programmes, where several different ‘non-regulated’ corporate entities sell exposures into a conduit;
- the existence of full support liquidity facilities provided by credit institutions to the benefit of investors in ABCP programmes;
- the capped maturity of the liability issued by the ABCP conduit (as per CRR) and the maturity transformation activity embedded in the ABCP assets and liabilities structure.

The differences mentioned justify designing a ‘qualifying’ framework that uses, as a basis, the criteria for qualifying term securitisations while distinguishing qualifying exposures at the ABCP transaction level from qualifying exposures at the ABCP conduit level and adjusting the criteria, where appropriate, to recognise technical specific characteristics of the securitisation mechanism in the context of ABCPs.

- A recommendation re-calibration of the BCBS 2014 framework applicable to ‘qualifying’ securitisation positions:

**RECOMMENDATION 5: Recommendation on the re-calibration of the BCBS 2014 framework applicable to ‘qualifying’ securitisation positions**

*Capital requirements for ‘qualifying’ securitisation positions should be re-calibrated downwards in a consistent fashion across the hierarchy of approaches foreseen by the BCBS 2014 securitisation framework, i.e. the Internal ratings based approach (SEC-IRBA), the external ratings-based approach (SEC-ERBA) and the standardised approach (SE-SA). The re-calibration proposals are summarised in Table 1 below. Specific re-calibrations of the SEC-ERBA for both long-term and short-term ratings are reported in Table 2 and Table 3 below.*

Rationale

- The re-calibration should, to the extent possible, maintain the consistency of capital charges applicable across the BCBS 2014 hierarchy of approaches to minimise potential distortions of regulatory incentives: re-scaling the supervisory ‘p’ parameter was considered as striking the best balance between ensuring a clear and transparent implementation of the adjustment and avoiding unintended distortions. Re-scaling the SEC-ERBA approach for both short-term and long-term ratings on the basis of the SEC-IRBA and SEC-SA re-calibrations was also deemed the best option to maintain the consistency of the resulting capital charges along the hierarchy.
- The prudential floor of 0.3 for the supervisory ‘p’ parameter was maintained as in the original BCBS 2014 framework so as to ensure, following the re-calibration, a minimum prudential capital surcharge on the securitisation, hence recognising that full neutrality of securitisation capital charges is neither desirable nor prudent. Also for prudential reasons the re-calibration across approaches has not modified any of the 1250% risk weighting requirements foreseen by the original BCBS 2014 framework, recognising that such requirements apply to conditions of relatively higher risk attached to the tranche;
- The 10% value chosen for the risk weight floor applicable to senior tranches has been chosen to recognise a materially better historical performance of qualifying senior tranches with respect to non-senior qualifying tranches, while maintaining a level of capital that more than covers historical losses of qualifying senior tranches;
- The overall re-calibration across approaches recognises that qualifying securitisation transactions are expected to be relatively less risky across the capital structure but maintains regulatory capital on levels of non-neutrality that are , as evidenced by impact assessment analysis, comfortably higher than the minimum levels foreseen by the BCBS 2014 original framework.

**Table 1 Recalibration proposals applicable to ‘qualifying’ securitisations**

BCBS 2014 Framework	Re-calibration proposal
SEC-IRBA	The ‘p’ parameter is re-scaled by a factor of 0.5 while preserving the prudential 0.3 floor value: $P_{\text{qualifying}} = \max[0.3; 0.5 \times (A+B * (1/N)+C*Kirb+D*LGD+E*Mt)].$

**BCBS 2014 Framework**      **Re-calibration proposal**

<b>SEC-SA</b>	The supervisory parameter p is rescaled from 1 to 0.5.
<b>SEC-ERBA (long-term ratings)</b>	Risk weights of the ERBA look-up table for each long-term rating grade are re-scaled to keep consistency with the re-scaled average risk weights in the SEC-SA approach resulting from the proposal above. The 1250% requirements of the BCBS 2014 framework remain unchanged (see below).
<b>SEC-ERBA (short-term ratings)</b>	Risk weights of the ERBA look-up table for each short-term rating grade are re-scaled to keep consistency with re-scaling proposed for the SEC-ERBA approach for long-term ratings. The 1250% requirements of the BCBS 2014 framework remain unchanged (see below).
<b>Risk weight floor</b>	For <u>senior</u> qualifying tranches only: SEC-IRBA and SEC-SA: the risk weight floor is lowered from 15% to 10% SEC-ERBA: the one-year and five-year risk weight floors are reduced from 15% to 10% and from 20% to 15%, respectively.

**Table 2 Proposed re-calibration of the SEC-ERBA risk weights for ‘qualifying’ transactions (original BCBS 2014 risk weights in brackets)**

Long-term rating	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity		Tranche maturity	
	1 year	5 year	1 year	5 year
AAA	10% (15%)	15% (20%)	15% (15%)	50% (70%)
AA+	10% (15%)	20% (30%)	15% (15%)	55% (90%)
AA	15% (25%)	25% (40%)	20% (30%)	75% (120%)
AA-	20% (30%)	30% (45%)	25% (40%)	90% (140%)
A+	25% (40%)	35% (50%)	40% (60%)	105% (160%)
A	35% (50%)	45% (65%)	55% (80%)	120% (180%)
A-	40% (60%)	45% (70%)	80% (120%)	140% (210%)
BBB+	55% (75%)	65% (90%)	120% (170%)	185% (260%)
BBB	65% (90%)	75% (105%)	155% (220%)	220% (310%)
BBB-	85% (120%)	100% (140%)	235% (330%)	300% (420%)
BB+	105% (140%)	120% (160%)	355% (470%)	440% (580%)
BB	120% (160%)	135% (180%)	470% (620%)	580% (760%)
BB-	150% (200%)	170% (225%)	570% (750%)	650% (860%)
B+	210% (250%)	235% (280%)	755% (900%)	800% (950%)
B	260% (310%)	285% (340%)	880% (1050%)	880% (1050%)
B-	320% (380)	355% (420%)	950% (1130%)	950% (1130%)
CCC+/CCC/CCC-	395% (460%)	430% (505%)	1250% (1250%)	1250% (1250%)
Below CCC-	1250% (1250%)	1250% (1250%)	1250% (1250%)	1250% (1250%)

**Table 3 Proposed re-calibration of the SEC-ERBA risk weights for short-term ratings for ‘qualifying’ transactions (original BCBS 2014 risk weights in brackets)**

Short-term rating	
A-1/P-1	10% (15%)
A-2/P-2	35% (50%)



**Short-term rating**

<b>A-3/P-3</b>	70% (100%)
<b>All other ratings</b>	1250% (1250%)

This opinion will be published on the EBA’s website.

Done at London, 07 July 2015

[signed]

Andrea Enria

Chairperson  
For the Board of Supervisors