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Synthetic securitization of undrawn revolving credit facilities

Question

In a synthetic securitisation of undrawn revolving credit facilities ("RCF"), which is compliant with Article 244 of CRR, what is the EAD that should be considered inside the securitisation (which will subject to the risk weighting according to the securitisation framework) and what is the EAD that should be considered outside the securitisation (which will continue to be risk weighted according to the approved IRB model for such exposures)?

Background on the question

For the purposes of this question, the securitised EAD (80% of day 1 EAD of the undrawn RCF) ranks pari passu with the non-securitised EAD (20% of day 1 EAD of the undrawn RCF).

In a portfolio of undrawn RCFs, the nominal value of the portfolio and EAD could be different (for example, assuming that the nominal of the undrawn RCF portfolio is 100, the EAD at day 1 of the portfolio is 30 (ccf= 30%) since it is totally undrawn). Also, the EAD of the underlying portfolio may also increase in the future as result of future drawings under the RCFs.

If a synthetic securitisation of a portfolio of undrawn RCFs references only a portion (say 80%) of the day 1 EAD (80% of 30= 24) and the securitisation tranches are fixed, (i.e. they do not change according to changes in the EAD as a result of future drawings under the RCFs), it could be understood that only 80% of the day 1 EAD associated with the RCFs (80%*30= 24 in the example) may be risk weighted according to the securitisation framework (i.e. the portion INSIDE the securitisation) and that 20% of the day 1 EAD associated with the RCFs (6 in the example) plus any future increases in EAD (as a result of future drawings) may be risk weighted according to the approved model for the underlying exposures (i.e. the portion OUTSIDE the securitisation).

Alternatively to the above, there could be other methods/interpretations to determine the portion of the EAD included INSIDE the securitisation at day 1 and in the future, and the portion of the EAD OUTSIDE the securitisation, for example, that in order to determine the EAD included INSIDE the securitisation, the nominal value of the RCFs instead of the EAD, or, when calculating the EAD, a CCF of 100% instead of 30%, is applied. Such alternative interpretations could result in significantly different RW on the retained tranches (at day 1 and in the future) and thus have an impact on the RWA savings deriving from the transaction (at day 1 and in the future).

Therefore the answer to the question is relevant to ensure that the practical calculation of the RWA released in synthetic securitisations of undrawn RCFs is consistently interpreted/calculated in all synthetic securitisations of undrawn credit facilities.

For example, when buying funded or unfunded credit protection for an amount equal to 80% of EAD at day 1 of the undrawn RCFs portfolio, can it be considered that 80% of the EAD is covered at day 1 (INSIDE the securitisation) and t that 20% of day 1 EAD plus any future increases in EAD (as a consequence of any drawings that might occur) will continue to be risk weighted according to the approved IRB model for such exposures (OUTSIDE the securitisation).

In other words, and according to Article 249 of CRR, should the originator institution consider such 80% of the EAD as the amount of pool of exposures included in the securitisation and therefore treat them in risk weighting under Chapter 5 (Securitisation) of title II (capital requirements for credit risk) of Part 3 of the CRR?

EBA answer

The following provisions have to be considered:

- Article 4(1)(61) of Regulation (EU) No 575/2013 (CRR) states that securitisation means a transaction or scheme whereby the credit risk associated with an exposure or pool of exposures is tranched.
- Article 5 CRR states that for the purposes of Part Three, Title II, exposure means an asset or off-balance sheet item.
- Article 166(8) CRR sets out that the exposure value (EAD) under the IRB approach of an undrawn credit facility shall be the committed but undrawn amount multiplied by a conversion factor, while Article 111 (1) CRR under the SA approach sets out percentages that apply to nominal values depending on the degree of risk.
- Article 4(1)(56) CRR sets out that conversion factor means the ratio of an undrawn commitment that would be outstanding at default.
- Article 5(1)(a) of Delegated Regulation (EU) No 625/2014 states the possibility of securitising part of the credit risk of an exposure or pool of exposures and retaining the rest of the risk as a form of risk retention.

In this context, a securitisation can be structured in a way that only part of the credit risk associated with an exposure or pool of exposures is tranched, which could correspond to either a percentage or a fixed amount of the exposure value (EAD), as there is no limitation in this regard as long as the retained part is compliant with the minimum risk retention requirement.

As an illustration, in the case described in the background, the credit risk associated with a fixed amount of the EAD of a pool of revolving credit facilities (RCFs) - which are fully undrawn and therefore a conversion factor in accordance with Article 166(8) CRR has been applied - is tranched via a synthetic securitisation at inception. The risk associated with the rest of the EAD of the securitised exposures at inception is not tranched (i.e. it is ranked pari passu with the credit risk that has been securitised) and retained by the institution in accordance with Article 5 (1) (a) of Delegated Regulation (EU) No 625/2014. Also, future increases in the EAD because of drawings will be fully retained by the institution. Therefore, in such a case, in the event that the originator institution achieve significant risk transfer, the untranched exposure at day 1 and the future increases in the EAD because of the drawings will be subject to the general credit risk provisions of Chapter 3 CRR, while the capital requirements corresponding to the securitised EAD, which is fixed throughout the life of the securitisation, will be calculated in accordance with Article 249 of Chapter 5 CRR.

Link
[EBA website link]