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AFME, UK Finance and CREFC Europe response to Discussion Paper 3/23 on securitisation capital requirements published by the Prudential Regulation Authority (the "PRA") on 31 October 2023

On behalf of the Association for Financial Markets in Europe ("AFME"),¹ UK Finance² and CREFC Europe³ and their respective members, we welcome the opportunity to respond to the PRA Discussion Paper 3/23 on securitisation capital requirements.

Responses to consultation questions

Q1. *To what extent do firms expect to be able to mitigate the potential impact of the output floor on securitisation exposures, including retained tranches of SRT securitisations? Please provide estimates of costs and benefits and / or illustrative examples.*

The Output Floor Issue - overview

¹ AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME advocates stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

² UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms, UK Finance acts to enhance competitiveness, support customers, and facilitate innovation.

³ The Commercial Real Estate Finance Council (CREFC) Europe is an industry association representing commercial real estate (CRE) debt providers and the wider European CRE finance market. CREFC Europe promotes well-functioning, responsible and sustainable markets that are appropriately transparent and liquid, serving both institutions investing capital (their own or on behalf of others) and CRE businesses borrowing it (large or small), without unduly threatening financial stability, and believes that a suitably regulated European CRE debt securitisation market would contribute towards that outcome.

As indicated in AFME and UK Finance's September 2021 joint response to HMT's Call For Evidence on the Securitisation Regulation,⁴ in analysis undertaken by Risk Control,⁵ and in the member-sourced data produced for purposes of this response and analysed below, the CRR 3.1 output floor has a disproportionate impact on securitisations, compared with its impact on non-securitised exposures, and represents an existential threat to significant risk transfer securitisations, making it difficult for bank originators to achieve a viable cost of capital for their securitisations,⁶ or to release capital at all for certain asset classes (the **Output Floor Issue**).

The significant increases in capital (for no underlying change in fact pattern) flowing from the output floor de-link the prudential treatment of securitisations from their inherent risks and appear disproportionate to any prudential benefits achieved.

Significant risk transfer securitisation is a key macro risk and capital management tool, facilitating lending to the real economy in the UK, the importance of which has increased in recent years, and continues to increase, with rising (Basel-driven) Pillar 1 capital requirements, and - following turbulence in international banking markets in Spring 2023 - greater recognition of the need for varied and stable funding sources. Loss of this tool would reduce UK banks' ability to manage their risks, and hence their resilience, particularly in times of stress, by transferring risks to non-bank entities (non-originator investors in SRT securitisations are invariably non-bank entities) in line with strict CRR and PRA significant risk transfer and commensurate risk transfer requirements. The availability of the SRT tool increases the banks' safety and soundness, and its loss would reduce their safety and soundness.

It would also result in competitive disadvantage for UK banks relative to their international peers and, by preventing access to capital management through SRT, potentially limit lending in affected underlying asset classes.

As discussed below, the potential mitigation strategies identified by the PRA in the discussion paper would not reverse the market-limiting impact of the Output Floor Issue, may not be practicable, and should not be relied upon, alone, or in (structurally complex) combination, to remedy the insufficiency of a primary mechanism (such as p factor reform) to address the Output Floor Issue.

The impact of the Output Floor Issue in the UK is accentuated due to: (i) the UK CRR and Securitisation Regulation not incorporating a 'simple transparent and standardised' (**STS**) securitisation regime (and associated prudential benefit for originators) for synthetic securitisations (though a similar concept limited to SME deals is, in theory, available under Article 270 UK CRR), (ii) issues, in practice, around the recognition of unfunded credit risk mitigation in the context of synthetic securitisations; and (iii) the non-exercise of the option under Basel to prevent capital requirements generated by the output floor from exceeding 125% of the unfloored requirements before 31 Dec 2029.

The relevance of the output floor at institutional and transactional level

As the PRA notes in the discussion paper, the proposed UK implementation applies the output floor metric at (broadly) UK consolidated and ring fenced sub-consolidated level, only. However, in practice, the output floor will be *highly* relevant at institution and transaction level. Any moderately well managed banking group will track impacts on UK consolidated capital requirements back to their institutional and transactional source ('those SRT trades you entered

⁴ See, in particular, pages 65-70 of Section 5 of Appendix 1 to the response.

⁵ <https://www.riskcontrollimited.com/wp-content/uploads/2023/03/Impact-of-the-SA-Floor-on-European-Securitisation-22-65a-14-6-22-v68-Revised.pdf>

⁶ The capital-adjusted cost of funding securitisation for a bank originator must be cheaper than for funding the assets on the balance sheet.

into last year don't work under the SEC-SA and are causing us output floor issues, please unwind them'). The economic cost/benefit analysis for proposed new SRT trades will also take into account their impact on consolidated level capital requirements, including the output floor ('that SRT trade you want to enter into makes perfect sense under the SEC-IRBA, but not when we take into account the output floor impact, so it's a no.'). Even groups for which the output floor is not currently engaged will need to conduct institution and transaction specific output floor sensitivity analysis in order to ensure that the output floor does not *become* engaged in future. While members welcome the PRA's indication in Basel 3.1 implementation related CP16/22 that (broadly) the output floor will not affect supervisory *SRT assessments*,⁷ they note that this is no fix at all for the Output Floor Issue.

Member-sourced data on the output floor and its interaction with different levels of p factor

Annex 1A contains detailed data and analysis in relation to the output floor and its interaction with different levels of p factor. This annex represents the output of a member bank's analysis, for real-world significant risk transfer securitisations, and covers multiple asset classes, including retail and non-retail assets. The analysis identifies: the impact of the output floor for these transactions in terms of % increase in weighted average risk weight of originator-retained tranches, the level of the SEC-IRBA p factor, the extent to which different levels of p factor could mitigate the output floor impact, the level of p factor that would neutralise the impact of the output floor entirely, the level of additional subordination that would be required in order to achieve a post-output floor senior risk weight of 15% (i.e. the risk weight floor for non-STS securitisation positions), and the way that level of subordination compares with the PRA's expectations (per supervisory statement 9/13) on the attachment point for senior tranches in securitisations of standardised assets (in which context, the PRA indicates that an attachment point of $1.5 \times K_{SA}$ is, generally, required in order to demonstrate commensurate risk transfer). The analysis also identifies the cost of capital increase relative to the SEC-IRBA cost of capital associated with the output floor at different levels of p factor.

As indicated in Annex 1A, following application of the output floor 'as is' (i.e. applying a p factor of 1), the securitisations analysed record an absolute c30% - 50% increase in the weighted average risk weight of originator-retained tranches⁸ from the risk weight floor, with increases mostly in the 40% - 50% range. This is in dramatic contrast to the output floor related change in risk weights for the *underlying assets* of the same securitisations (i.e. the change in the assets' risk weights prior to securitisation) where the change is in the range approximately -6% (i.e. a 6% reduction in risk weight) to +10%. The cost of capital increase is in the range approximately 3.6x to 108x the SEC-IRBA cost of capital. The securitisation transactions analysed will, clearly, no longer be economically viable.

As indicated in Annex 1A, at a p factor of 0.7 (rather than 1), the weighted average risk weight of originator retained tranches in the securitisations analysed would remain approximately 12% to 29% up on the equivalent pre-output floor risk weights, with increases mostly in the 20%-30% range. The cost of capital increase would remain in the range 1.5x to 2.3x the SEC-IRBA cost of capital.

A p factor of 0.5 would bring the increase in the weighted average risk weights down to approximately 1%-16%, with increases mostly in the 5%-15% range and bring the cost of capital increase down to 1.1x to 1.4x the SEC-IRBA cost of capital.

⁷ "...the output floor would not directly affect the supervisory assessment of commensurate risk transfer under CRR Articles 244 and 245, the calculation of maximum risk weights and RWAs in Articles 267 and 268, nor the PRA's expectations in relation to the thickness of sold or protected tranches for portfolios of SA exposures". See page 321 Box A, paragraph 2, as confirmed in the discussion paper at paragraph 2.7.

⁸ Across all retained tranches, including the first loss tranche where applicable.

Annex 1A also demonstrates that, in order to achieve the same residual risk weight for the originating bank post output floor (i.e. applying a p factor of 1 to these non-STS transactions and structuring for the retained senior securitisation position to remain at the non-STS 15% risk weight floor) by purchasing additional protection, the retained senior securitisation position would need to attach at $2.64 - 2.94 \times K_{SA}$. This is a level of subordination far in excess of the PRA's expected attachment point for senior tranches/ detachment point of protected tranches in securitisations of standardised assets at $1.5 \times K_{SA}$ (per requirements in supervisory statement 9/13).

The data in Annex 1B relates to the impact of the output floor for another member bank's live synthetic CLO deals, highlighting the absolute increase in attachment point of the senior tranche required to achieve the same residual risk weight for the originating bank following the application of the output floor (i.e. applying a p factor of 1 to these non-STS transactions and structuring for the retained senior securitisation position to remain at the 15% floor for non-STS transactions). The average attachment point under the SEC-IRBA to achieve the 15% risk weight for the senior tranche under the SEC-IRBA is 6.1% (with attachment points in the range 4.5% to 8.6%). Following the application of the output floor, the average attachment point for the senior tranche is 22.35% (with attachment points in the range the range 20.6% to 23.5%).

Members' opposition to option 1 ('do nothing') and the concerns that this option raises in terms of the PRA's own objectives

Members strongly oppose the 'do nothing' option identified, as option 1, by the PRA. It is useful to consider the, very negative, impact of option 1 in relation to the PRA's objectives - which members wholeheartedly support.

Safety and soundness risk: potential loss of SRT as a key macro risk management tool

In terms of the PRA's primary objective of promoting the safety and soundness of PRA-authorized firms, loss of SRT as a key macro risk management tool for banks (the consequence of 'doing nothing'), would significantly undermine this objective. SRT is a tried and tested mechanism facilitating risk transfer from the banking to non-banking sectors subject to strict eligibility requirements, and has a proven track record. There have been no recorded examples of senior tranches in SRT securitisations in the UK or EU bearing losses since the GFC.

Safety, soundness and proportionality: non-risk sensitive and disproportionate capital calibration potentially disincentivising economic activity and prudent structuring

In relation to both the safety and soundness objective and the PRA's duty to consider whether the impact of measures implemented by it is proportionate to their benefits: members note that doing nothing would result in capital calibration for securitisation transactions that is non-risk sensitive and disproportionate to their underlying risks. Such disproportionate capital calibration would disincentivise economic activity (SRT securitisation, and the underlying lending to the real economy that depends on it), which would otherwise be undertaken in a more risk-aligned prudential environment. It would also disincentivise prudent structuring and risk mitigation in relation to securitisations that remain viable.

Competitiveness and growth of the UK economy: potential additional capacity to lend and/or to improve pricing for existing SME customers, and additional SRT securitisable asset classes, that could be unlocked with reduced p via Pillar I adjustments

In terms of the PRA's secondary objective to act, so far as reasonably possible, in a way that facilitates, subject to aligning with relevant international standards: (a) the international competitiveness of the economy of the UK (including, in particular, the financial services sector

through the contribution of PRA-authorized firms); and (b) its growth in the medium to long term: analysis undertaken by members indicates that lower p factors for synthetic securitisations under the standardised approach would be associated with significant additional lending to SMEs. On a representative £200 million pool of SME lending, a (non IRB) UK bank member calculates that the difference between a p factor of 1 and a p factor of 0.5 (whether flowing from a general change in SEC-SA p factor in connection with the Output Floor Issue, or from an STS regime for synthetic securitisations) would release approximately £2.4 million of additional capacity to lend and/or to improve pricing for existing SME customers. (The difference between a p factor of 1 and a p factor of 0.7 would result in £0.85 million of additional capacity.)

It is difficult to accurately measure the amount of future lending that would be unlocked for the real economy, due to uncertainty in borrower demand elasticity. However, it is reasonable to suppose that the combined effect across the UK banking sector (especially smaller non-IRB banks) could be considerable when looking at cheaper financing for existing products and additional lending capacity in product segments with returns that were previously unattractive on a relative basis. For example, at a lower p factor, SRT could be used effectively, and in a value accretive manner for, for example, asset finance, development finance, and dealer floor plan transactions.

Conversely, the additional protected tranche thickness per transaction associated with higher p factors reduces investor market capacity to undertake other transactions. For example, the same (non-IRB) UK bank member calculates that for a hypothetical £250 million SME transaction, the protected tranche would increase from £30 million in nominal value at a p factor of 0.5, through £40 million in nominal value at a p factor of 0.7, to £50 million in nominal value at a p factor of 1.

Alignment with relevant international standards: risk of uncompetitive unilateral adherence by the UK

While ‘doing nothing’ might offer perfect compliance with Basel, the Basel standards - as the PRA itself notes - have historically not been (and it appears will not be⁹) implemented uniformly across jurisdictions. Adherence to international standards which are not implemented in other major jurisdictions would be highly relevant, and damaging, to the UK’s international competitiveness.

Effective competition in markets for services: the purposive function of the output floor is to reduce excessive variability in models (however, the disproportionately high output of the SEC-SA does point to a need for reform of the securitisation risk weighting framework more broadly).

In terms of the PRA’s secondary objective of facilitating effective competition in the markets for services provided by PRA-authorized firms in carrying on regulated activities, members note that the objective of the output floor, as articulated at Basel level is to “reduce excessive variability of risk-weighted assets and to enhance the comparability of risk weighted capital ratios” (see Basel RBC 20.11). It is a metric designed to reduce unjustified variability in the output of the internal ratings-based capital requirements.

Members note, however, that the genesis of the Output Floor Issue for securitisations, is the inherently very large difference between the output of the standardised (SEC-SA, SEC-ERBA) and internal ratings based (SEC-IRBA) approaches to calculating securitisation capital requirements (i.e. a result of the Basel calculation mechanics themselves, rather than model/interpretation variability by institutions), which appears to have been overlooked in the construction of the

⁹ Even, in all likelihood, in the US (which, on paper proposes a very conservative implementation of the rules) given the very significant political and industry opposition to the measures. Members note that the US has, at the present date, not implemented the securitisation prudential reforms introduced in the CRR in 2019.

output floor metric. This inherently great difference in output does point to a need for reform (ideally in a quicker timeframe than would be possible at an international level) of the securitisation standardised approaches more broadly to counter their excessive non-neutrality.

The inadequacy of potential mitigation strategies to address the Output Floor Issue #1 – obtaining an ECAI rating and using the SEC-ERBA

The potential mitigation strategies identified by the PRA in the discussion paper would not reverse the market-limiting impact of the Output Floor Issue, may not be practicable, and should not be relied upon, alone, or in (structurally complex) combination, to remedy the insufficiency of a primary mechanism (such as p factor reform) to address the Output Floor Issue.

Risk weights can be more conservative under the SEC-ERBA than under the SEC-SA in circumstances where eligible ratings are available and would have to be used

Obtaining (and maintaining) ratings from external credit assessment institutions (**ECAIs**) for securitisation exposures, as envisaged by the PRA as a potential mitigation strategy, would assist market participants in relation to the Output Floor Issue only in circumstances where the risk weight associated with a securitisation position under the SEC-ERBA is materially lower than the risk weight applicable under the SEC-SA. However, as discussed in more detail in Question 6 below, the comparative risk weights generated under the SEC-ERBA and SEC-SA are understood to be very mixed/variable (i.e. they are far from universally more favourable under the SEC-ERBA) and can be more conservative under the SEC-ERBA than under the SEC-SA for the very asset classes most adversely impacted by the output floor. Some desks in member banks envisage significant uplifts to the applicable capital requirements (in some cases, doubling of capital requirements) resulting from the mooted change in hierarchy, in circumstances where eligible ratings are available and would have to be used. A particular issue with revision to risk weighting hierarchy along the lines contemplated (relevant to RMBS transactions and some CLOs and corporate loan warehouses) is understood to exist for AAA and AA rated senior non-STS, positions with a maturity greater than one year.

Obtaining credit ratings is costly and operationally burdensome, it is also potentially impractical for certain asset classes, for challenger banks, and for investors

Obtaining a rating is, as discussed in more detail in Question 6 below, also costly and administratively burdensome, it is likely to be particularly impractical for the less granular and less standardised, higher risk weight density, asset classes most associated with the synthetic securitisation structure, such as large corporates and project finance. Obtaining a rating may be particularly problematic for challenger banks (who would therefore be even less able to benefit from this mitigation strategy in circumstances where there is, in fact, a prudential benefit to use of the SEC-ERBA).

As well as depending on the revision of the securitisation risk weighting hierarchy – which, as discussed in Question 6 below, members oppose, this mitigation strategy would generally be feasible only for originators/sponsors retaining positions in a securitisation and not for investors investing in securitisations structured by third parties.

Given the cost, impact on structuring and lack of significant improvement to the resulting capital requirements, members do not envisage that ratings would be widely sought for SRT transactions.

The inadequacy of potential mitigation strategies to address the Output Floor Issue #2 – purchasing additional credit protection

As indicated above, the potential mitigation strategies identified by the PRA in the discussion paper would not reverse the market-limiting impact of the Output Floor Issue, may not be practicable, and should not be relied upon, alone, or in (structurally complex) combination, to remedy the insufficiency of a primary mechanism (such as p factor reform) to address the Output Floor Issue.

Greatly increased costs of protection associated with purchasing additional protection: resulting economic non-viability of transactions and high-cost credit protection issues

Purchasing additional credit protection, for example on mezzanine tranches, as envisaged by the PRA as a mitigation strategy in relation to the Output Floor Issue could, indeed, have the effect of reducing Pillar 1 capital requirements and the difference between the RWAs for retained tranches calculated under the SEC-IRBA and the SEC-SA or the SEC-ERBA, or eliminating the difference altogether if the risk weight falls to the floor of 15% (for non STS securitisations) in the SEC-IRBA and SEC-SA. This approach would, however, also render the economics of affected transactions unworkable (even if it became possible – as members hope – to do this on an unfunded basis), due to the reduced capital relief afforded, and additional costs of protection.

Please see the data in relation to the costs associated with purchasing additional protection to mitigate the Output Floor Issue at Annex 1A which illustrates this point.

The percentage cost of the aggregate protection would reduce slightly, but the nominal amount of protection would increase greatly, resulting in significantly increased overall transaction cost. Another member bank (for example) identifies a likely average 25% increase in transaction cost as a proportion of RWA relief. This means that it would remain difficult for bank originators to achieve a viable cost of capital for their securitisations.

More importantly, this would likely lead to SRT costs of protection becoming decoupled from the risk being transferred with little if any additional economic risk being associated with the additional thickness of protection purchased, but investors expecting a return for providing that additional thickness, especially in funded transactions where the investor's funds are 'locked up' for the duration of the transaction. The purchase of additional protection could, thus, easily lead to High Cost of Credit Protection (HCCP)¹⁰ issues.

As indicated above, members note the PRA's general requirement for the attachment point for retained senior tranches/detachment point for protected tranches in SRT securitisations of SA portfolios to equal or exceed $1.5 \times K_{SA}$ ¹¹. As discussed above, analysis undertaken by members (also at Annex 1A) indicates that the detachment point of credit protection required to mitigate the transaction level impact of the output floor would exceed this threshold by a considerable margin: $2.64 - 2.94 \times K_{SA}$.

Greatly reduced risk sensitivity of capital requirements associated with purchasing additional protection disincentivising both economic activity and prudent structuring

A mitigation strategy based on the purchase of additional protection would also greatly reduce the risk sensitivity of the resulting prudential requirements, de-linking the prudential treatment of these structures from their inherent risks. This would be adverse in terms of the PRA's safety and soundness objective in disincentivising prudent structuring and risk mitigation in relation to securitisations that remain viable and PRA's duty to consider whether the impact of measures implemented by it is proportionate to their benefits, disincentivising economic activity (SRT

¹⁰ As referenced in PRA SS 9/13 at 6.5 and in Basel guidance www.bis.org/publ/bcbs_n16.htm.

¹¹ See PRA SS 9/13 at 8.2: "The PRA considers it prudent for firms to apply a scalar of 1.5 to K_{SA} to determine the minimum value of D for the purpose of justifying commensurate transfer of risk."

securitisation and the underlying lending to the real economy that depends on it), which would otherwise be undertaken in a more risk-aligned prudential environment.

Feasibility issues in terms of mezzanine investor yield targets and overall market capacity

As the PRA identifies, the scope for the mitigation option involving purchase of additional protection would also, potentially, be constrained by investor appetite and market capacity. Members note that the high detachment points driven by the output floor would result in transactions the risk profile of which implies yields below the yield targets of typical mezzanine investors.

In terms of overall market capacity, it is also important to note that while there is a large, and expanding, base of investors willing to purchase **first loss and junior mezzanine** tranches, the investor base for synthetic, often unrated, **senior mezzanine tranches** is much less developed. In effect forcing banks to begin purchasing thicker uni-tranches or additional senior mezzanine protection, en masse, could result in a significant mismatch between supply and demand, resulting in the SRT market ceasing to function efficiently and putting these important risk and capital management transactions at risk. This issue is further compounded by the current lack of recognition/clarity around the parameters for recognising unfunded credit risk mitigation in UK SRT transactions, since the market for funded senior mezzanine participations exists but is very limited. Originators' own internal policies and frameworks in relation to unfunded credit risk mitigation could also be relevant limiting factors. Any appeal beyond the existing SRT investor base to traditional, non SRT, ABS investors would be uncertain and have knock-on consequences in terms of cost and complexity.

Members' views on potential p factor reforms to address the Output Floor Issue

Adjusting p factor in the SEC-SA for all purposes ('option 2') is an optimal solution if calibrated to resolve the Output Floor Issue (requiring a p factor of, at most, 0.5 for non-STS transactions). Inadequately calibrated, option 2 would give rise to the same issues as doing nothing ('option 1')

Members welcome the PRA's openness to adjusting p factor in the SEC-SA, for all purposes, to address the Output Floor Issue ('option 2'). Appropriately calibrated, this would be an optimal solution. Members note, however, that, at the 0.7 value referred to in the discussion paper (as the level to which there is "scope for reducing the p factor" without falling below the SEC-IRBA p factor in "most" securitisations of "non-retail exposures", presumably meaning non-STS transactions, given that the p factor for STS transactions (including STS SRT traditional securitisations, and – in theory – synthetic SRT transactions qualifying for an STS equivalent prudential benefit under Article 270 CRR) is already set at 0.5), the change would not result in economically viable securitisations in the asset classes otherwise impacted by the Output Floor Issue, so would not resolve the issues identified.

As indicated in the Annex 1A, at a p factor of 0.7, the weighted average risk weight of originator retained tranches for the transactions analysed would remain in absolute terms approximately 12% to 29% up against pre-output floor risk weights, with increases mostly in the 20%-30% range. As previously noted, the change in risk weights for the underlying assets of those transactions (prior to securitisation) would be in the range of approximately -6% to +10% only.

Inadequate p factor reform (failing to resolve the Output Floor Issue) would give rise to the same negative impacts identified in relation to Option 1 above in relation to the PRA's objectives concerning safety and soundness, proportionality and international competitiveness (while weakening absolute – but as discussed above potentially unilateral! – adherence to international standards). Any reform (Option 2, or 3) that adequately resolves the Output Floor Issue, by contrast, will be positive in relation to safety and soundness, proportionality and international

competitiveness. Adjusting the p factor in the SEC-SA for all purposes (Option 2, as opposed to Option 3) would, however, helpfully, counter what members perceive as the excessive non-neutrality of the SEC-SA pointing to the need for its reform more broadly.

In order to reverse the market-limiting impact of the Output Floor Issue, members believe, a p factor of, at most 0.5 would be required for non-STS transactions. As indicated in the Annex 1A data, a p factor of 0.5 would bring the increase in the weighted average risk weight of originator retained tranches for the transactions analysed down to approximately 1%-16%, with increases mostly in the 5%-15% range. At this level, the increases in the securitisation risk weights would exceed increases in underlying assets risk weights by a reasonable margin, but would not be grossly disproportionate to the changes in underlying asset risk weight.

Members do not see a clear basis or rationale for distinguishing p factors between particular asset classes, or transaction features, as envisaged by the PRA and note that this would also increase complexity within the SA.

We note the PRA's concern that the p factor in the SEC-SA should not generally fall below the p factor in the SEC-IRBA. Members note that the risk weight formula under the SEC-SA is more conservative than the risk weight formula under the SEC-IRBA in respects other than the p factor (for example, in incorporating the higher SEC-SA underlying asset capital requirements, and in the treatment it applies to defaulted assets), so that the burden of conservatism in the formula does not fall exclusively to the p factor. It is also possible for the SEC-IRBA p factor (the level of which depends on a number of risk variables) to equal the SEC SA p factor of 1 (or for STS transactions 0.5). If, however, the PRA remains determined to ensure that the SEC-SA p factor remains equal to or higher than the SEC-IRBA p factor it could impose a floor on the SEC-SA p factor at the SEC-IRBA p factor. Realistically, in order to ensure that it was calculable, such a floor would presumably need to be implemented for purposes of the output floor calculation only, so apply to IRB banks only (i.e. if adopting Option 3 – see below).

We note the PRA's concern that the p-factor in the SEC-SA for non-STS securitisations should remain higher than the p-factor for STS securitisations. We agree that, as a preferential treatment for conservatively structured transactions, the p factor for STS securitisations should be lower than that for non-STS securitisations, but that the p factor for non-STS securitisations should be set on its own merits as discussed in this response and that, logically, the p factor for STS securitisations should therefore be adjusted downwards in line with the non-STS p factor.

In relation to the PRA's concern that the reforms should not unduly exacerbate cliff effects we note that the STS regime for traditional securitisations currently operates with a p factor of 0.5, presumably without concern that this is problematic in terms of cliff effects, which we would recognise as justifiable given the still substantive capital surcharge at that level of p. We also note that the unmitigated output floor itself represents a dramatic cliff effect: its application (or otherwise) dramatically impacting the capital requirements for securitisations otherwise applying the SEC-IRBA on either side of an apparently somewhat arbitrary regulatory line.

If the PRA feels constrained from adjusting the p factor on a basis calibrated to resolve the Output Floor Issue for all purposes under the SEC-SA, it should do so for originators' retained senior positions in SRT securitisations only, on the basis of their arguably zero agency and model risks ('modified option 2'), failing which, it should adjust the p factor, on a basis calibrated to resolve the Output Floor Issue, for purposes of calculation of the output floor only ('option 3'), failing which, it should adjust the p factor on a basis calibrated to resolve the Output Floor Issue for purposes of calculation of the output floor only for originators' retained senior positions in SRT securitisations

If the PRA feels constrained from facilitating p factor reductions at levels consistent with alleviating the Output Floor Issue for SRT securitisations (see quantitative analysis above) due to its proposal to do this on a general *basis for all securitisations* under the SEC-SA, it should consider making p factor changes on a general basis under the SEC-SA that are limited to *originators' retained senior positions in SRT securitisations*. Such positions could potentially be distinguished on the basis of the reduced agency and model risks associated with investment in own-originated assets in the originator's own securitisation. There can, for example, be no concerns re data asymmetries with the sell side justifying prudential non-neutrality of the securitisation relative to the underlying assets where the holder of a securitisation position is the asset originator (although, in members' view, the extensive disclosure requirements now applicable to securitisations go a long way to addressing data asymmetry issues) and no concerns about reliance on third parties to service the assets.

We understand the PRA's concern to apply p factor mitigation in an even-handed way as motivating its 'option 2' proposal for general amendment of the p factor, for all purposes, under the SEC-SA. However, in practice, the Output Floor Issue is most material for originator's retained senior positions in SRT securitisations, where the SEC-IRBA is the primary approach. Members understand that, in most non-SRT securitisations (undertaken for funding rather than capital relief purposes), a change in the p factor would, in any case, not impact senior exposure risk weights which are typically already structured to achieve (and cannot go below) the 15% (non-STS) / 10% (STS) risk weight floor. Therefore, while we note the PRA's initial concerns on Option 3, we would highlight, in relation to a specific carve-out to the output floor calculation that: (i) this is unlikely to undermine the objectives of the output floor, as the main impact would be for originator's retained senior positions in SRT securitisations where the inherent risks are reduced and would justify a lower p-factor (as discussed above); (ii) the majority of such positions are currently calculated under SEC-IRBA, thereby reducing any potential for a non-IRB bank to be disadvantaged; and (iii) the overall impact on mis-alignment with international standards would be reduced or the same versus the PRA's Option 2, by nature of the reduced scope of the p-factor divergence.

If the PRA feels constrained from facilitating p factor reductions at levels consistent with alleviating the Output Floor Issue for all securitisations, *or* for originators' retained senior positions in SRT securitisations only, due to its proposal to do this on a general basis under the SEC-SA, it should consider making such p factor changes specific to the calculation of the output floor (i.e. adjustment to the SEC-SA p factor, exclusively for purposes of calculation of the output floor) at a level that would actually resolve the Output Floor Issue (see quantitative analysis above), either for securitisations in general or for originators' retained senior positions in SRT securitisations, i.e. proceeding based on 'option 3'. This would, in members' view, be greatly preferable to inadequate adjustment of p for all purposes, under the SEC-SA, failing to resolve the Output Floor Issue.

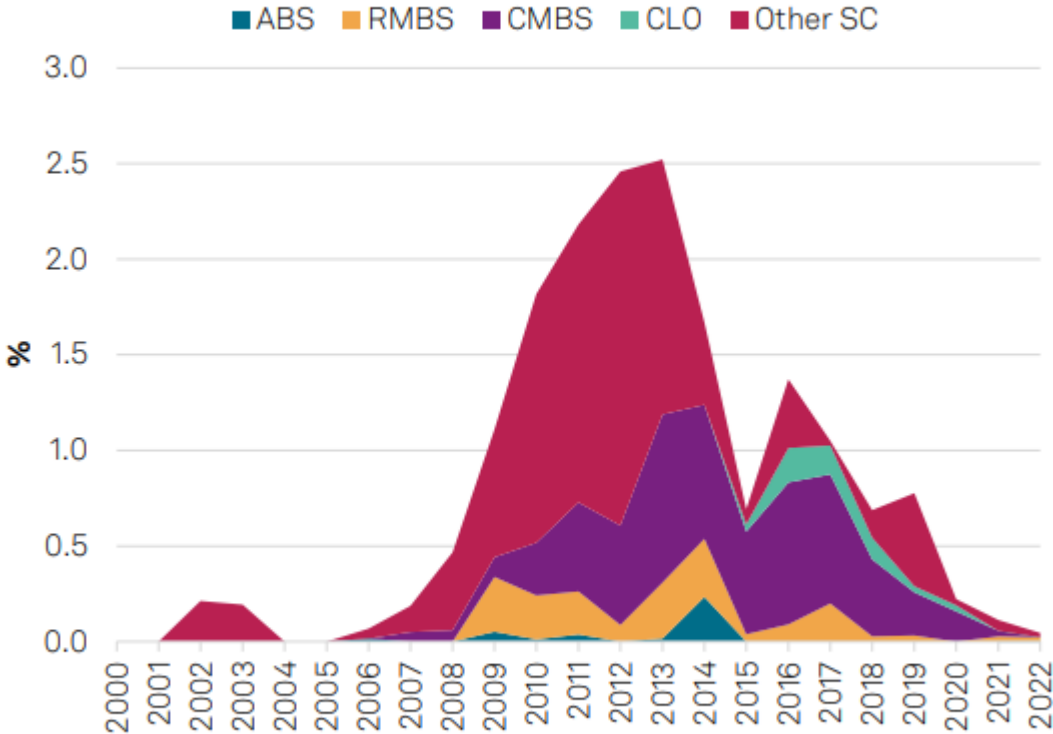
Grandfathering

The PRA could equally (as referenced in the discussion paper) effect carve-outs to the output floor (presumably in the sense of exclusion from both the numerator and denominator of the output floor, or from the required standardised basis of calculation within the output floor) for exposures to SRT securitisations. The case for exclusion from the output floor would be particularly pronounced in relation to existing securitisations (i.e. securitisations executed prior to the entry into force of CRR 3.1), in particular, if an appropriate p factor adjustment is not applied pursuant to option 2 or 3. The consequence of, in effect, applying the SEC-SA methodology to a securitisation which has already been tranching based on the SEC-IRBA methodology will usually be to generate a risk-weight for the senior retained tranche significantly in excess of 100%, meaning the cap under Article 268 CRR will apply and the securitisation generate no regulatory capital relief for the purposes of the originator's output floor calculations.

The desirability of a broader review of the calibration of the Pillar 1 securitisation prudential framework, ideally at UK domestic level pending action at international level

In relation to the broader question as to the appropriateness of the current calibration of the Pillar 1 framework for determining capital requirements for securitisation exposures, members understand that, when the output floor was being discussed at Basel level, no consideration was given to the effect of the floor on securitisation (or, indeed, on the continued viability of non-securitisation credit risk mitigation). As the PRA is aware, in what may be an accident of drafting rather than a reasoned policy decision, the output floor effectively applies a double layer of increased conservatism to securitisation exposures (an increase in conservatism at the level of the underlying portfolio risk weights and an increase in conservatism at the level of the securitisation formula), resulting in an uplift that is significantly greater than for other exposure classes. Beyond this specific issue, the re-calibration of the Basel securitisation framework post-the global financial crisis (which, ironically, the US has not yet implemented) was largely based on the experience of US sub-prime securitisations and failed to reflect the realities of UK and European securitisation performance, which remained strong even through the GFC:

Annual default rate, European sector contributions



SC--Structured credit. Source: S&P Global Market Intelligence CreditPro.

Of the defaults that have been observed in the UK and EU all are, AFME data indicate, associated with structures documented prior to the GFC (2004-2007): structural protections in post GFC transactions (such as prevailing levels of subordination) are much greater.

The data on which the re-calibration of the Basel securitisation framework was based on US RMBS and pre-date the non-prudential securitisation reforms (in relation to risk retention, disclosure, due diligence, credit-granting, and re-securitisation) implemented since the GFC. The cumulative

effect of Basel reforms since, and including, those implemented in the CRR in 2019 therefore now needs to be considered, in order to ensure that all banks that are engaged in UK securitisation markets can expand their capacity to serve the UK market and the UK's role as a global financial centre. Members therefore strongly support the PRA's view that there is a need for "an evaluation of the securitisation capital framework, particularly its level of 'non-neutrality', by the BCBS", and urge the PRA to make representations to the BCBS as the desirability of *reductions* in the overall level of non-neutrality. While international standards are important, significant differences between national and regional markets should not be ignored and proportionate capital requirements sacrificed on this altar. Given the very lengthy timeframe likely to be involved in effecting change at Basel level, members would strongly support a domestic review on this topic in the UK. Members stand ready to assist the PRA with any such review, as required.

Timing considerations in relation to p factor reforms to address the Output Floor Issue

Members note the PRA's proposed timetable for pursuing the potential p factor reforms envisaged above, as part of a proposed consultation in H2 2024 (on the transfer to PRA rules of the firm-facing requirements in the CRR securitisation chapter). As previously flagged to the PRA, although the output floor will (on current proposals) apply, from 1 July 2025, with a ramp-up period in to 2030, investors are likely to hold banks to the fully loaded output floor from 1 July 2025. Further, it is not possible for an originator to structure a deal *today*, if it is uncertain whether the economics will remain viable from 1 July 2025. Delay in signalling policy direction on this matter is a *current* issue for the market. This uncertainty also has the potential to impact current lending / origination decisions relating to underlying assets in asset classes that are typically securitised.

Q2. *How do you consider that option 2 could be developed?*

See response to Q1 above.

Q3. *To what extent could the p-factor be reduced while meeting the constraints set out in paragraph 2.36? Please provide evidence that would support this assessment. Are there other constraints that the PRA should consider?*

See response to Q1 above.

Q4. *To what extent could option 2 address industry feedback about the interaction between the output floor and Pillar 1 capital requirements?*

See response to Q1 above.

Q5. *What are your views of the different policy options in relation to the interaction between the output floor and Pillar 1 framework for determining capital requirements for securitisation exposures?*

See response to Q1 above.

Q6. *What would be the initial and ongoing impact on: (i) capital requirements; (ii) operational requirements; and (iii) securitisation structures of changing the UK securitisation hierarchy of methods to better align with Basel standards? Please provide any data on these impacts.*

Members are opposed to revising the risk weighting hierarchy certain consequences of which appear to be in tension with the PRA's objectives

Members are opposed to the contemplated revision to the securitisation risk weighting hierarchy to (broadly) prioritise the SEC-ERBA over the SEC-SA.

As indicated below, the impact on capital requirements of the contemplated change (which is mixed overall) would, for certain transaction types, be adverse and unavoidable and have meaningful negative implications in terms of trading and, as a result liquidity provision, in the market. The negative impact on trading and liquidity provision would be an adverse outcome in terms of the PRA's safety and soundness objective.

In relation to the PRA's suggestion that change to the hierarchy could "*result in more risk-sensitive capital requirements for some securitisation exposures*", members note that the converse can be true in the sense that ratings are inherently slow to adjust in both directions. A seasoned, de-levered, structure is meaningfully lower risk than a freshly originated deal, but this sensitivity would be lost through application of the SEC-ERBA.

Given the cost and additional structuring complexity associated with ratings (discussed below), and lack of significant improvement (where there is improvement) in the resulting capital requirements, associated with use of the SEC-ERBA, members do not envisage that ratings would be widely sought for SRT transactions. Such additional cost and structuring complexity moreover seem hard to reconcile with the PRA's duty to consider whether the impact of measures implemented by it is proportionate to their benefits.

The current risk weighting hierarchy is well understood in the UK

Members note that the JC of the ESAs, in its report on the securitisation prudential framework for banks¹² (the **ESAs' Securitisation Prudential Report for Banks**), identified some confusion around the application of Article 254(2) EU CRR in the EU. However, members believe that the current hierarchy is well understood in the UK. Members note that, having been in effect for five years, the hierarchy has been coded into banks' reporting systems, change to which would, they feel, be disruptive, and for some transaction types adverse, for little purpose.

The mooted change to the hierarchy would increase reliance on external credit ratings contrary to general regulatory trend to avoid this (to minimise cliff effects & herd behaviour)

The prioritisation of the SEC-ERBA over the SEC-SA within the securitisation framework also appears counterintuitive in light of the general objective, in the Basel 3 reforms of "*reduc[ing] mechanistic reliance on external credit ratings*"¹³. This general objective flowed from October 2010, Financial Stability Board principles for standard setters and regulators aimed at "*reducing cliff effects and herding behaviour that threaten financial stability and were seen to arise from external credit assessment thresholds being hardwired into laws, regulations and market practices*"¹⁴.

Other key jurisdictions do not apply the hierarchy

As discussed above in relation to p factor reform, the merits of absolute adherence to international standards appear much reduced where (as is the case in relation to this aspect of the risk weighting hierarchy) they are not adopted, or are differently adopted, by other major jurisdictions (the US, for example, barring the use of credit ratings as well as, per the current

¹²https://www.eiopa.europa.eu/system/files/2022-12/jc_2022_66_-_jc_advice_on_the_review_of_the_securitisation_prudential_framework_-_banking.pdf

¹³ <https://www.bis.org/fsi/fsisummaries/rcrf.pdf>

¹⁴ See paragraph 1.2: <https://www.bis.org/bcbcpub/d307.pdf>

proposals (though, as indicated above, their prospects of their implementation look dim) all use of credit risk models for prudential purposes).

Comparative risk weight outcomes under the SEC-SA and SEC-ERBA are mixed, with significant increases in capital requirements (as indicated by member-sourced data) for RMBS transactions and some CLOs and corporate loan warehouses. Member-sourced data also identifies significant increases in capital requirements for a UK CRE small balance portfolio

It is hard to be definitive in this area, since much depends on portfolio specifics and rating agency discretion / conservatism. Although there clearly are scenarios in which use of the SEC-ERBA could mitigate the Output Floor Issue, it is understood that the impact of the risk weighting method used varies considerably by asset class and by duration, for example, corporate loans might be expected, in general, to generate higher risk weights applying the SEC-ERBA than would apply under the SEC-SA, while retail portfolios such as mortgages or autos might be expected, in general, to generate lower risk weights under the SEC-ERBA than would apply under the SEC-SA. The SEC-SA may also produce comparatively better outcomes in seasoned deals where credit enhancements have built up. Some desks in member banks envisage significant uplifts to the applicable capital requirements (in some cases, doubling of capital requirements) resulting from the mooted change in hierarchy, in circumstances where eligible ratings are available and would have to be used. A particular issue with revision to risk weighting hierarchy along the lines contemplated (relevant to RMBS transactions and some CLOs and corporate loan warehouses) is understood to exist for AAA rated, senior, non-STS, positions with a maturity greater than one year. Generally, such positions have a SEC-ERBA risk weight of 15%, however, where the maturity of the position exceeds five years, the SEC-ERBA risk weight rises to 20%. The impact of this risk weight increase would typically be felt by banks holding high quality exposures. Higher capital requirements in relation to such seasoned, high rated, notes would likely lead to cost increases, in the real economy, for the borrowers of their underlying assets, and would have a negative impact on the notes' market liquidity where traded. For such longer maturity transactions where the senior securitisation position is AA, rather than AAA, rated the risk weight increase is more dramatic (15% to 40% for transactions with a five-year maturity, 15% to 32.50% for transactions with a three year maturity).

Comparative data relating to risk weight outcomes associated with obtaining a credit rating and applying the SEC-ERBA versus applying the SEC-SA for affected asset classes is provided at Annex 2. This identifies very significant uplifts in risk weight under the SEC-ERBA as compared with the SEC-SA discussed above for AAA and AA rated senior tranches in CLO / corporate loan warehouses and CLO / RMBS mortgage warehouses.

In addition, a (non-IRB), UK bank member has compared estimated SEC-SA and SEC-ERBA capital requirements for a typical UK CRE small balance portfolio. Under the SEC-ERBA, they identified an uplift in risk weight (20% as compared to 15% under the SEC-SA) and a significant uplift, of approximately 37%, in capital requirements (an increase of approximately £8.6 million on a £200 million portfolio).

Members note that a comparison of SEC-SA risk weights with the risk weights under the SEC-ERBA also does not take into account additional Pillar 2A amounts that may be required to be held in respect of securitisation positions.

The mooted change to the hierarchy could give rise to trading and market liquidity issues

A requirement to apply the SEC-ERBA would, as indicated above, add meaningfully to the risk weighted assets for a sizeable population of securitisation positions. A range of upper mezzanine securitisation positions have appreciably better liquidity as a result of the viability of using the SEC-SA rather than the SEC-ERBA for those positions and loss of that approach would have

negative implications for liquidity provision to the market. Upcoming changes to the trading book treatment of securitisation positions under the fundamental review of the trading book will result in increased risk weighted assets for these positions and there is already significant risk that meaningful portions of the ABS market will no longer be supported by trading desks, a risk which the proposed change to the hierarchy would exacerbate.

ECAI ratings are not always optional – they may be required for a variety of (mainly liquidity-related) reasons

It might, at first glance, appear that use of the SEC-ERBA in a revised hierarchy would be, in effect, discretionary (i.e. that the sell side could obtain ECAI ratings in order to facilitate use of the SEC-ERBA, or avoid ECAI ratings in order to facilitate use of the SEC-SA at will). If that were the case, flipping the hierarchy to ‘SEC-ERBA first’ would create beneficial flexibility. However, members note that, where ECAI ratings are available in a transaction for reasons unrelated to risk weighting – as may be the case for a number of reasons – use of the SEC-ERBA would not be discretionary, with such transactions being ‘forced’ into the SEC-ERBA. This is true, for example, of ratings obtained for liquidity purposes in STS traditional securitisations of asset classes (residential mortgages, auto loans, SME and individual loans) the senior tranches of which are eligible for recognition as high quality liquid assets (**HQLA**) for purposes of the liquidity coverage ratio (**LCR**) subject to achieving requisite ECAI ratings. It is also true (i.e. eligible ratings are likely to be available, making use of the SEC-ERBA mandatory) of transactions where rating is required for non-LCR related liquidity reasons such as in connection with collateral eligibility for central bank liquidity schemes, in connection with notes’ use as repo collateral, or where rating is required in the context of syndicated/club deals.

(Members note, further, that use of the SEC-ERBA is not always discretionary as a technical matter, in the sense that it applies to “*rated positions [and] positions in respect of which an inferred rating may be used*”.¹⁵ On this basis, the existence of an eligible rated tranche can cause a tranche in respect of which a rating has not been sought to be caught by the rules around inferred ratings in Article 263(7) CRR.¹⁶ However, this is not regarded as a particularly substantive issue.)

Obtaining ratings is costly (as indicated by member estimates)

Obtaining a rating is costly.

The requirements of Article 8c of the Credit Rating Agency Regulation for structured finance instruments generally mean that it is necessary to obtain at least two credit ratings.

Members estimate major rating agencies’ initial upfront costs to be approximately £250,000 per agency (with Moody’s ratings generally coming in slightly higher), there is also an annual running cost of approximately £30,000 (for monitoring and maintaining the rating). Given the two-rating requirement, the direct cost of ratings is therefore approximately £500,000 in upfront costs with an annual running cost of £60,000 per annum. In addition to the direct costs, originators incur costs associated with the internal resources required to obtain the rating. The extensive

¹⁵ Article 254(1)(c) UK CRR

¹⁶ “For the purposes of using inferred ratings, institutions shall attribute to an unrated position an inferred rating equivalent to the credit assessment of a rated reference position which meets all of the following conditions: (a) the reference position ranks *pari passu* in all respects to the unrated securitisation position or, in the absence of a *pari passu* ranking position, the reference position is immediately subordinate to the unrated position; (b) the reference position does not benefit from any third-party guarantees or other credit enhancements that are not available to the unrated position; (c) the maturity of the reference position shall be equal to or longer than that of the unrated position in question; (d) on an ongoing basis, any inferred rating shall be updated to reflect any changes in the credit assessment of the reference position.

originator analysis conducted by the ECAI results in a requirement to produce additional data fields for ECAI reporting. This involves an estimated 400 employee-hours. Based on an average assumed salary across the relevant data teams (data, credit, underwriting, servicing and collections, exco) of £135,000 per annum and a 20 day working month with eight working hours per workday this results in an additional cost of £28,000.

Obtaining a rating can also be operationally onerous, and is potentially impractical for certain asset classes, for challenger banks, and for investors.

There may be a requirement to document otherwise undocumented retained senior tranches in order to obtain a rating. In members' experience, rating agencies will often also add to negotiating complexity, for example, imposing covenants that neither issuers nor investors consider necessary/relevant.

Obtaining a rating may be particularly impractical for the less granular and standardised, higher risk weight density, asset classes most associated with synthetic structures, such as large corporates and project finance. It may also be problematic for challenger banks (e.g. due to preparedness for the scrutiny involved in relation to the institution as a whole), who would therefore be even less able to benefit from this mitigation strategy (in circumstances where there is, in fact, a prudential benefit to use of the SEC-ERBA).

The utility of ECAI ratings to the external (first loss/mezzanine) investors in these deals, who conduct their own highly detailed risk assessments would also be very limited.

If the hierarchy is changed as proposed (which members oppose) there will be a need to facilitate use of the SEC-IRBA in relation to investment in third party securitisations

If the hierarchy is changed, as proposed, it should be made feasible/realistic to apply the SEC-IRBA to securitisations of third party originated assets. Members understand that it has historically not been permitted, in the UK, to use proxy data to build a model to establish a pool risk weight for a broad sector (UK BTL, CLO etc). However, Basel permits use of "the treatment for eligible purchased receivables" to calculate Kirb, subject to specified eligibility requirements (CRE 44.6-44.9).

Grandfathering will be required in relation to any revision to the securitisation risk weighting hierarchy

Any change in the risk weighting hierarchy (which as indicated above, members oppose) should be accompanied by permanent (non-time-limited) grandfathering in respect of existing securitisations. It is an important principle of legal certainty that changes in law or regulation should not be imposed with retrospective or retroactive effect. Exercise of regulatory calls is a last resort and adverse to the interests of investors, originators, and their regulators. An absence of grandfathering could lead to the exercise of a large number of regulatory calls in a short space of time.

Q7. Do you have any feedback on the PRA's views on the scope of the UK STS framework? Please provide any supporting evidence.

Members request confirmation that existing Article 270 CRR (an STS equivalent regime for synthetic SME deals) remains available for use

Members note that the UK CRR continues, at Article 270, to provide for synthetic securitisations meeting specified requirements (including compliance with the majority of the STS requirements

applicable to traditional securitisation¹⁷) to benefit from an STS-equivalent prudential treatment where 70% of the securitised assets by principal amount are credit exposures to SMEs. UK market participants have not, to date, members believe, made use of the provisions of Article 270 UK CRR. The lack of use of this mechanic is understood to evidence a perception/concern that – notwithstanding the black letter of the law sanctioning its use – the PRA may not take a favourable view of the provision. Members would welcome confirmation from the PRA that Article 270 UK CRR remains available for use in accordance with its stated terms.

Members' regard an STS regime for synthetic securitisations of all asset classes as desirable, offering benefits in terms of transaction standardisation, reduction in barriers to entry for new market participants, and, where associated with prudential benefits, increased volumes of risk transfer (with associated benefits to the real economy and banks' resilience)

In members' view there is strong justification for STS regime for synthetic securitisations of all asset classes associated with a prudential benefit for originators in terms of the PRA's secondary international competitiveness objective. Members also believe that it is perfectly possible to implement such a regime consistent with the PRA's primary safety and soundness objective and that the framework could be subsumed within the PRA's existing STS operational infrastructure.

As indicated above, the impact of the Output Floor Issue is accentuated due to the UK CRR and Securitisation Regulation not incorporating an STS framework for synthetic securitisations (and associated prudential benefit for originators) for synthetic securitisations, so that the availability of such a regime (particularly in terms of an associated p factor reduction for originators) could (depending on its terms and calibration) help to mitigate the issue for eligible transactions.

In relation to the concerns relating to Basel compliance, articulated by the PRA, in connection with the development of an STS framework for synthetic securitisations, members note that given the existence of the Article 270 regime, the creation of a broader framework for STS synthetic securitisation would not change the current position of UK law relative to Basel, substantively, but *would* create a fairer, more level, playing field between different asset classes and between traditional and synthetic securitisation formats.

Members further note that the current Basel STC regime evolved from an existing European framework and that the relationship between international and national/regional regulation is not uni-directional.

Members note that synthetic securitisations are not complex structures. They are simple structures (at their most basic, unfunded guarantees) and, in many respects (ease of execution, absence of asset transfer mechanics etc.), significantly simpler than traditional securitisations.

While members agree with the PRA that the existing base of expert first loss and mezzanine investors in SRT synthetic securitisations has little interest in enhanced regulatory transparency requirements (having bespoke due diligence requirements which they have no problem satisfying bilaterally), the increased transaction standardisation associated with the STS framework benefits both originators and investors. As law firm associate members (who see a wide range of transactions) can attest, the impact of STS for synthetic securitisations in other jurisdictions *has* been a helpful greater standardisation of these instruments. The increased level of publicity around the expected terms of these instruments associated with explicit STS eligibility requirements has helped to increase understanding of the product beyond existing market participants and reduced barriers to entry for new originators and investors.

¹⁷ Compliance with Articles 18 and 20(1)-(6) UK CRR is not required.

The association of the STS label with a prudential benefit for originators, improving the economics of these transactions, in the UK, would be expected to result in increased risk transfer. As indicated above, risk transfer securitisation facilitates lending to the real economy and is a useful tool for institutions, particularly in times of stress.

As indicated above in discussion of the p factor in the context of the Output Floor Issue, in relation to the “growth” of the UK economy, referred to in the UK’s secondary competitiveness objective, analysis undertaken by members indicates that lower p factors for synthetic securitisations under the standardised approach would be associated with significant additional lending to SMEs. On a representative £200 million pool of CRE assets, a (non IRB) UK bank member calculates that the difference between a p factor of 1 and a p factor of 0.5 would result in approximately £2.4 million of potential additional capacity to lend and/or to improve pricing for existing SME customers. (The difference between a p factor of 1 and a p factor of 0.7 would result in £0.85 million of additional capacity.) It is difficult to accurately measure the amount of future lending that would be unlocked for the real economy, due to uncertainty in borrower demand elasticity. However, it is reasonable to suppose that the combined effect across the UK banking sector (especially smaller non-IRB banks) could be considerable when looking at cheaper financing for existing products and additional lending capacity in product segments with returns that were previously unattractive on a relative basis. For example, at lower p factor, SRT could be used effectively, and in a value accretive manner for, for example, asset finance, development finance, and dealer floor plan transactions.

Conversely, the additional protected tranche thickness per transaction associated with higher p factors reduces investor market capacity to undertake other transactions. For example, a (non-IRB) UK bank member calculates that for a hypothetical £250 million CRE portfolio transaction the protected tranche would increase from £30 million in nominal value at a p factor of 0.5, though £40 million in nominal value at a p factor of 0.7, to £50 million in nominal value at a p factor of 1.

In general, members believe, eligibility for prudential benefits associated with STS should be assessed based on the characteristics of the securitised assets and not on the mechanic (true sale versus credit risk mitigation) by which they are securitised.

Q8. *What is the appetite of bank originators for buying funded or unfunded credit protection in synthetic SRT securitisation?*

What are the pros and cons to originators of funded versus unfunded credit protection in synthetic SRT securitisation?

Which assets, structures, levels of tranches in capital stack are attractive for achieving SRT or additional credit protection in an unfunded way and why?

Members support the use of unfunded credit risk mitigation in the context of SRT synthetic securitisation, as envisaged by Basel and the CRR and would like to understand the PRA’s position better

Given the PRA’s evident desire, in other contexts (such as in relation to the Basel securitisation risk weighting hierarchy and formulae), to align with the Basel framework, it appears odd to members that unfunded credit risk mitigation, which is clearly recognised at Basel level, and in Article 249 of the UK CRR, as an eligible form of credit risk mitigation for purposes of synthetic securitisation, has not (in members’ experience), historically, been permitted in the UK (at least to the extent of the risk transfer required to achieve significant risk transfer – members are aware of additional unfunded tranches having been inserted into existing synthetic securitisation structures post-closing, mainly for economic purposes).

Members very much welcome dialogue with the PRA on this topic. It would be helpful, in particular, to have a common understanding of the scope of the possible in terms of the PRA's current approach (for example are there conceptual floors on the permissible attachment point for unfunded credit risk mitigation in a synthetic securitisation context?).

Market certainty that use of unfunded credit risk mitigation in SRT securitisations is permitted would be expected to unlock significant additional deal-flow.

It is, conservatively, estimated that unfunded investment could facilitate approximately £500 million of mezzanine note issuance per annum in the UK, with £250 million coming from the British Business Bank, and £250 million coming from private (re-)insurance. The total unfunded investment over 5 years would be (conservatively) expected to reach £3 billion. As indicated above, risk transfer securitisation facilitates lending to the real economy and is a useful tool for institutions, particularly in times of stress.

The combination of funded and unfunded credit risk mitigation would be expected to diversify and hence improve due diligence and reduce systemic risk

The combination of funded investment in junior tranches and unfunded investment in mezzanine tranches would be expected to increase appetite for both types of investor to engage in these trades, and to improve the quality of due diligence, with additional 'eyes' involved and increased diversity of methodologies. Systemic risk would be expected to be reduced by the introduction of new sources of protection: insurance and, in relation to unfunded SRT for SME lending exclusively, the British Business Bank.

The market for unfunded credit risk mitigation

The ability to use unfunded credit risk mitigation, particularly credit insurance, is attractive to originators and investors. A market for investment in senior mezzanine risk outside the UK has come into existence and developed rapidly in recent years in response, in particular, to the necessity, under the 2019+ revised CRR securitisation risk weighting hierarchy, to place thicker tranches of risk in order to achieve the same level of risk weighted asset reduction, it remains in the process of expansion. Insurers also express appetite for investing in more junior tranches of risk, particularly for certain asset classes such as residential mortgages.

As a private market, overview data in relation to the identity of investors in funded and unfunded significant risk transfer securitisation is hard to come by, however a recent ESRB report¹⁸ includes the following high-level estimates, for the EU, from a survey conducted with key originating banks. Of the categories shown, "insurance companies" and "supranationals, public development funds" would be providers of unfunded credit protection, though the latter are not (currently) a significant feature of the UK securitisation market.

¹⁸ 3 October 2023 <https://www.esrb.europa.eu/pub/pdf/occasional/esrb.op23~07d5c3eef2.en.pdf>

Key investor categories active in the SRT market

Type of firm	Estimated share of total SRT market credit protection sold
Credit funds specialised in SRT transactions	45%
Insurance companies	5%
Pension funds	5%
Supranationals, public development funds	15%
Asset managers	30%

Source: survey ECB data (June 2023).

IACPM's yearly private surveys on SRT securitisations involving private credit insurance evidence the trend, identified above, of growth in the insurance SRT sub-market. IACPM's global 2022 surveys indicate that insurers participated in European risk transfer transactions backed by close to EUR 80 billion in underlying loans (of which 55% were SME / corporate loans), while overall bank issuance represented approximately EUR 200 bn. Though not exactly comparable, these figures suggest that the 5% insurance market share indicated in the ESRB data represents a significant underestimate.

Advantages of unfunded credit risk mitigation

Changes to the CRR securitisation risk weighting requirements in 2019, resulted in a requirement to place thicker tranches in order to achieve the same capital relief benefit as under the pre 2019 regime. The unfunded credit risk mitigation format offers a cost-effective way for originators to address this challenge. Since premia in unfunded credit protection arrangements do not have to support collateral funding costs, they are significantly lower than those in funded credit protection arrangements. This difference is accentuated in a high interest rate environment, with recent and projected increases in interest rates increasing the differential, and incentive to use unfunded arrangements. The use of insurance is also risk-effective for originators, in the sense of diversifying available protection types. Insurers also generally syndicate the tranches acquired, retaining on average only 35% of the risk (IACPM survey 2022), which assists with the diversification of counterparty risk. The involvement of insurers in the synthetic securitisation market also increases the overall supply of potential protection providers, providing greater market capacity to absorb risk, as well as pricing benefits for originators flowing from competition. The thicker the placed risk, the less likely it is that a single investor will be able to assume all of it consistent with its risk appetite. A diversity of protection providers with different risk appetites, including insurers, is therefore welcome to originators for this reason, also.

Insurers have particular expertise in relation to certain asset classes, such as residential real estate. Members note their experience and volume of participation in the US CRT market.

Potential disadvantages of unfunded credit risk mitigation

In terms of disbenefits, originators of unfunded credit risk mitigation arrangements are (as discussed further below) left with a residual exposure to the credit protection provider. In order to achieve the same level of capital relief as in a funded arrangement, the originator in an unfunded arrangement therefore needs to place a thicker tranche of risk. Per advocacy efforts in other I, the applicable regulatory LGD value in the FIRB approach does not appear commensurate with the risks involved (it appears to be too high). Under the standardised approach (including its application to IRB banks via the output floor) insurers may be required to be treated as unrated corporates generating a 100% risk weight, although the PRA proposes an elective alternative treatment designed to mitigate this adverse outcome¹⁹.

Insurers acting as providers of unfunded protection in synthetic securitisations do so from the liability side of their balance sheets. It is also technically possible for insurers to invest in traditional and funded synthetic securitisations from the asset side of their balance sheets, however, as indicated in AFME and UK Finance's September 2021 joint response to HMT's Call For Evidence on the Securitisation Regulation²⁰, treatment of investment in securitisation from the asset side of insurers' balance sheets remains highly disadvantageous under Solvency II. While the capital calibrations for senior STS tranches have been set to levels which are comparable to corporates, non-STS securitisations – including all synthetic securitisations in the UK, given the absence of a synthetic STS framework – carry very high charges as Type 2 securitisations. Even the calibrations for non-senior STS tranches – potentially relevant to traditional SRT securitisations – remain disproportionately high, creating strong disincentives to investment.

The very different (and 'tighter') terms seen in insurance policies used in the context of significant risk transfer transactions and their very different operation (which is mechanistic rather than dependent on the insurer's claims handling/assessment process) – both as discussed below – has, historically, been a cultural / organisational barrier to participation for insurers although this is no longer the case.

Grandfathering

Any change in the PRA's approach/guidance around unfunded credit risk mitigation in significant risk transfer securitisations that is restrictive relative to the current (permissive) CRR position should be accompanied by permanent (non-time-limited) grandfathering in respect of existing securitisations (few though they currently are). It is an important principle of legal certainty that changes in law or regulation should not be imposed with retrospective or retroactive effect. Exercise of regulatory calls is a last resort and adverse to the interests of investors, originators, and their regulators.

Q9. *What is the appetite of credit protection providers for extending funded or unfunded credit protection in synthetic SRT securitisation?*

What are the pros and cons to credit protection providers of extending funded or unfunded credit protection in synthetic SRT securitisation?

Who might be the providers of unfunded and funded credit protection? Are there any specific impediments to insurance companies from extending credit protection to synthetic SRT securitisation?

Which assets, structures, levels of tranches in capital stack are attractive for extending unfunded credit protection?

See response to Q8 above.

¹⁹ A risk weight of 65% for investment grade obligors, but 135% for non-investment grade obligors.

²⁰ See pages 64, 72 and 73 of Appendix 1 to the response, in particular.

Q10: How and to what extent might contractual arrangements mitigate any prudential risks posed by unfunded CRM in SRT securitisations?

Members note that the concerns identified by the PRA are not specific to synthetic securitisations but apply to all insurance/guarantee protection recognised prudentially

The PRA identifies the following as prudential risks associated with unfunded credit risk mitigation in significant risk transfer securitisations: (i) the risk of late payment or non-payment of the credit protection amount when a borrower or counterparty defaults; and (ii) the risk that the unfunded credit risk mitigation provider may be downgraded and then cease to be eligible to provide unfunded credit risk mitigation, necessitating alternative arrangements to continue to achieve SRT.

As an overarching comment, members note that concerns identified above have no specific or inherent connection with securitisation or SRT, being potentially relevant to every insurance contract written, whether tranching or untranching. There is no clear logical justification, or regulatory rationale, for treating securitisation more harshly than other credit risk mitigation techniques due to risks that are inherent in all such transactions.

The risk of late payment or non-payment of the credit protection amount is mitigated by residual risk weights and contractual protections in SRT documentation (which differs significantly from conventional non-payment insurance)

In relation to the risk of non-payment, we note that the CRR mechanics for recognition of unfunded credit risk mitigation address this risk directly. Where unfunded credit risk mitigation is provided in respect of a tranche, the protection buyer does not cease to hold capital in respect of the protected tranche, but, rather, amends the risk weight associated with the protected tranche to reflect the risk weight of the protection provider / the IRB input(s) of the protection provider, See Articles 251(2) and 249 CRR. Except in the case of unfunded credit protection providers that benefit from a statutory 0% risk weight, which do not include insurers²¹, a residual risk weight will apply reflecting the probability of the insurer's default. We note that Article 249 CRR provides some additional conservatism in relation to credit risk mitigation written on securitisation positions through the imposition of specified mandatory minimum ratings requirements for protection sellers.

In relation to the risk of late payment, as indicated, we note that insurance policies used in the context of significant risk transfer transactions (**SRT insurance policies**) have significantly 'tighter' terms than those used in the context of non-securitisation unfunded credit risk mitigation (**conventional non-payment insurance**), making them more onerous from the perspective of the protection seller (insurer) and more certain from the perspective of the protection buyer. Excluding provisions relating to structural features that are irrelevant to unfunded credit protection (notably provisions relating to collateral mechanics and SPVs), the terms of SRT insurance policies are substantively identical to those used in the context of funded significant risk transfer transactions. The notification and quantification of credit claims – while they may involve third party check-box verification – are mechanised and very much controlled by the protection buyer (with the protection buyer's internal accounting entries and prudential estimates being determinative in relation to quantum). The insurer's claims handling/assessment department is not involved in the way seen in conventional non-payment insurance – pools are, indeed, often 'blind' with no visibility on the insurer's side as to the identity of underlying obligors. The lengthy waiting periods, and potential for additional information requests and dialogue, associated with conventional non-payment insurance are not seen: the market

²¹ E.g. specified central governments/central banks/multilateral development banks.

generally follows the requirements of STS for synthetics in other jurisdictions – applicable to both funded and unfunded credit protection – in ensuring interim payments within, as a maximum, six months of a credit event, with such periods normally much shorter than this. Information/disclosure requirements are aligned with those in funded deals and explicitly documented, while non-contractual duties of disclosure and fair presentation that may otherwise arise in insurance-based protection are excluded. Certain exclusions sometimes seen in conventional non-payment insurance (notably nuclear exclusions) are not included.

Data on payment rates and insurer defaults provide comfort in relation to the risk of late payment or non-payment of the credit protection amount

The use of insurance in significant risk transfer securitisations is too recent a development to facilitate provision of long-term data evidencing the making of pay outs, especially given that protection has typically been written on senior mezzanine tranches which have a low probability of being affected by defaults. However, such data is available in the context of conventional non-payment insurance where, as indicated above, the terms of the relevant policies are typically less restrictive and protection-buyer friendly than SRT insurance policies.

According to data published by Risk Control Limited (claims under policies covering comprehensive non-payment for regulated financial institutions where the insurer was contractually required to accept liability in 2022), submissions by the participants in this year’s survey indicate that 100% of the claims made by regulated financial institutions in 2022 were honoured as required by the insurance contract.

Data on claims and paid claims in conventional credit insurance for the period 2017-2022 included in a June 2023 ITFA/IACPM joint white paper (Credit Insurance as a Credit Risk Mitigant to Diversify Risk Under the Capital Rules)²² indicate that 97.73% of the value of all claims were paid in full, constituting 98.35% of all claims made in total during this period (even in the small balance explained by contractual non-compliance of the protection buyer, 44% of the amounts claimed were paid).

	2007 – 2020	2021	2022
Total claims paid to banks	578	140	190
Total Amount Claimed	\$3,753,470,551	\$1,010,242,049	\$529,534,436
Total Amount Paid	\$3,633,104,370	\$1,010,242,049	\$529,534,436
Compromised Claims	15	0	0

Data on insurer downgrades/defaults provide comfort in relation to the risk of risk of insurers being subject to ratings downgrades and ceasing to be eligible to provide unfunded credit risk mitigation

Under Article 249 CRR, eligible providers of unfunded credit protection in respect of securitisation positions are required to have a credit rating of CQS2 (broadly A) or better at inception of the transaction, and CQS3 (broadly BBB) or better thereafter. Based on S&P historical data 1981-2022, members note that, of European insurers rated A (i.e. CQS2), only 1.16% have ceased to be rated A or BBB or better (i.e. CQS 2 or 3 or better), or defaulted, within three years (0.10% defaulting):²³

²² Based on data supplied by A2Z Risk Services Ltd dated April 2023,

²³ S&P 2022 Annual European Corporate Default and Rating Transition Study (25 May 2023), table 12 page 20.

Average three-year transition rates, 1981-2022 (%)

Europe	From/To	AAA	AA	A	BBB	BB	B	CCC/C	D	NR
	AAA	65.07	23.29	2.40	0.11	0.23	0.00	0.11	0.00	8.79
		(15.34)	(12.84)	(3.38)	(0.76)	(1.21)	(0.00)	(0.82)	(0.00)	(8.93)
	AA	0.69	64.60	21.83	2.30	0.32	0.00	0.02	0.05	10.19
		(1.39)	(11.69)	(9.65)	(2.39)	(0.54)	(0.00)	(0.12)	(0.16)	(4.29)
	A	0.02	3.88	69.68	11.67	0.81	0.16	0.09	0.10	13.61
		(0.10)	(3.12)	(8.51)	(4.29)	(1.41)	(0.55)	(0.31)	(0.19)	(3.82)
	BBB	0.00	0.19	9.26	65.17	6.32	0.95	0.25	0.28	17.58
		(0.00)	(2.15)	(2.84)	(8.41)	(3.07)	(1.00)	(0.52)	(0.71)	(5.62)
	BB	0.00	0.00	0.43	11.26	44.37	10.76	0.69	1.97	30.52
		(0.00)	(0.00)	(0.85)	(3.70)	(8.53)	(3.58)	(1.06)	(2.48)	(6.98)
	B	0.00	0.00	0.00	0.59	7.99	39.20	6.07	8.26	37.89
		(0.00)	(0.00)	(0.00)	(1.09)	(4.59)	(8.08)	(2.72)	(5.91)	(8.74)
	CCC/C	0.00	0.00	0.00	0.25	0.75	13.43	9.20	42.79	33.58
		(0.00)	(0.00)	(0.00)	(0.91)	(2.12)	(11.00)	(8.45)	(16.26)	(14.31)

Contractual protections also mitigate the risk of insurers being subject to ratings downgrades and ceasing to be eligible to provide unfunded credit risk mitigation

SRT insurance policies also invariably contain contractual protections in relation to the risk that downgrades in the unfunded protection provider's credit rating (by an ECAI and/or, where direct exposures to the protection provider are IRB, by the protection buyer) render it ineligible under Article 249(3) CRR and the protection consequently unrecognisable by the protection buyer. Downgrade triggers apply, normally entitling the protection buyer to replace the protection seller in the event that the requisite ratings (or such higher ratings as the protection buyer may specify) are lost. The premium payable to the protection seller in an unfunded arrangement is also likely to be linked to its credit rating, such that a ratings downgrade results in a reduction in the premium payable, potentially coupled with a right for the protection seller to procure the novation of the policy to an appropriately rated replacement (that is otherwise eligible and acceptable to the protection buyer). We note that, while specific CQS requirements do not apply in relation to non-securitisation unfunded credit risk mitigation, there is never the less a requirement for corporate providers of non-securitisation unfunded credit protection (such as insurers) to be rated (by an ECAI or, where direct exposures to the protection provider are IRB, by the protection buyer), which creates a similar cliff effect in that context (see Article 201(1)(g)). As far as we are aware, the PRA is not uncomfortable with this risk in that context. We note that the syndicated nature of insurers' participation in synthetic securitisation transactions facilitates their replacement.

Other issues/comments

Data availability issues under CRR 3.1

Members note that the calculation of SA capital requirements for certain underlying asset classes under the CRR 3.1 proposals (as required under the SEC-SA in relation to SA portfolios, and, for purposes of the output floor only, in relation to IRB portfolios) involves some data that is not currently available to banks in relation to existing assets (see Annex 3 for detail). While this is a general issue under CRR 3.1, it is accentuated in securitisation transactions by the fact that an investing bank may obtain access to the requisite information only via investor reports which the (potentially unregulated) transaction sell side are unable/unwilling to update (the required information may never have been captured and will not ever be retrievable), while the underlying asset pools may be highly granular (with tens of thousands of data points relevant to a single securitisation position). A significant impact on the real economy might be expected to result from termination of affected transactions, and a solution is required to prevent this scenario from

occurring. An ability for the investing bank to make conservative assumptions in the absence of the requisite data for existing securitisation positions would go some way to addressing the issue, but would still be expected to result in terminations, and an ability to apply pre CRR 3.1 methodologies in these circumstances would be a more robust fix. The industry would welcome the opportunity to discuss this issue with the PRA.

Request for clarification in relation to the mechanics for recognition of unfunded credit protection in respect of securitisation positions

The mechanics for recognition of credit protection in respect of securitisation positions cross-refer to, and require the application of the mechanics contained in, Chapter 4 of the CRR (see Article 251(2) CRR and 249(1)-(2) CRR). In respect of unfunded credit protection, Chapter 4 requires application of the risk weight substitution approach (a method that involves substituting the risk weight of the exposure with that of the protection provider to reflect the effect of UFCP) to exposures in respect of which an institution applies the standardised approach to credit risk (and per the PRA's proposed guidance on CRM mechanics in its consultation on Basel 3.1 implementation CP16/22,²⁴ also in situations where a comparable direct exposure to the protection provider would be risk weighted in accordance with the standardised approach to credit risk) and requires application of the parameter substitution approach (i.e. substituting probabilities of default (PDs) and, optionally, FIRB loss given default (LGD) values, of the exposure with those of the protection provider to reflect the effect of UFCP) to exposures to which the institution applies the foundation internal ratings based approach²⁵ - (provided, per the PRA's proposed guidance on CRM mechanics in its consultation on Basel 3.1 implementation CP16/22²⁶, that a comparable direct exposure to the protection provider would be risk weighted in accordance with the foundation IRB (FIRB) or advanced IRB (AIRB) approach (Article 236(1) CRR)).

The SEC-IRBA, SEC-SA and SEC-ERBA approaches to calculating capital requirements for securitisation positions generate risk weights which are applied to the exposure amount of a securitisation position to generate its risk weighted exposure amount. These calculations do not involve the IRB inputs PD or (FIRB) LGD and parameter substitution, where Chapter 4 requires application of the parameter substitution approach, is therefore not technically possible. No alternative mechanic is provided. Article 264 in the pre-2019 CRR explicitly permitted (broadly) risk weight substitution for IRB exposures. Members would welcome clarification that a similar approach can still be adopted – i.e. that the risk weight substitution approach can be applied to securitisation positions.

²⁴ see 5.45

²⁵ And presumably also, in the context of securitisation exposures, for which Chapter 4 mechanics are required under Article 251(2) CRR, the AIRB approach.

²⁶ see 5.45

Annex 1A

The output floor and its interaction with different levels of p factor

Phase	SEC-SA 'p'	Asset Class	Project Finance	Large Corporate	SME (Unrated)	Auto (Unrated)	
Pre-securitisation		IRB RW	67.50%	50.00%	67.00%	60.00%	
		STD RW	100.00%	83.00%	85.00%	75.00%	
		STD Output Floor RW	72.50%	60.18%	61.63%	54.38%	
		Output Floor Impact*	+5.00%	+10.18%	-5.38%	-5.63%	
Post-securitisation		Rated?	N	N	N	N	
		SEC-IRBA 'p'	0.57	0.48	0.42	0.57	
		Senior Attachment Point ('AP')	10.30%	7.00%	8.50%	9.70%	
		Protected Tranche AP	0.00%	0.00%	1.00%	1.50%	
		WA Retained SEC-IRBA RW (%)	15.00%	15.00%	25.65%	27.01%	
		p=1.0	WA Retained Output Floor RW (%)	64.30%	63.77%	66.19%	56.46%
			Output Floor Impact	+49.30%	+48.77%	+40.54%	+29.45%
			Cost of Capital Increase (versus SEC-IRBA)	+3.6x	+41.4x	+108.3x	+13.8x
	p=0.7	WA Retained Output Floor RW (%)	40.36%	43.99%	45.97%	38.78%	
		Output Floor Impact	+25.36%	+28.99%	+20.32%	+11.77%	

	Cost of Capital Increase (versus SEC-IRBA)	+1.5x	+1.9x	+2.3x	+1.9x
p=0.5	WA Retained Output Floor RW (%)	24.93%	30.82%	32.79%	28.00%
	Output Floor Impact	+9.93%	+15.82%	+7.14%	+0.99%
	Cost of Capital Increase (versus SEC-IRBA)	+1.1x	+1.1x	+1.4x	+1.2x
	'p' necessary to neutralise Output Floor impact	0.37	0.26	0.39	0.48
	Senior AP (multiple of K_{SA})	1.29	1.05	1.25	1.62
p=1.0	Senior SEC-SA RW if Senior AP = 1.5x K_{SA}	73.50%	58.67%	62.97%	64.38%
	Senior AP to reach Output Floor (SEC-SA) \approx 15% (multiple of K_{SA})	2.94	2.64	2.76	2.87

Output Floor impact demonstrates effective output floor impact to institution, assuming output floor is binding for institution and calculated as 72.5% of Standardised equivalent approach risk weight

Annex 1B

The output floor impact: the required attachment point for the senior tranche in a member bank's live CLO deals required to achieve a 15% risk weight under the SEC-SA

For reference: the average attachment point in the same transactions to achieve the 15% risk weight for the senior tranche under the SEC-IRBA is 6.1% (the range 4.5% to 8.6%).

The p factor		Sold tranche SEC-IRBA p factor (between 0.32 and 0.41)	p factor=0.5	p factor=0.7	p factor=1
Lowest attachment point to get 15% RW for retained senior tranche under SEC-SA	Average	9.63%	11.80%	15.55%	22.35%
	Range	8.4%-10.8%	10.9%-12.4%	14.4%-16.3%	20.6%-23.5%

Annex 2

Risk weight impacts SEC-SA vs SEC-ERBA for affected asset classes

CLO / corporate loan warehouses

5 years +

Rating	AAA	AA
Underlying	100%	100%
Suboord	40%	35%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	5	5
RW Sec SA	15.00%	15.00%
RW ERBA	20.00%	40.00%

3 years

Rating	AAA	AA
Underlying	100%	100%
Suboord	35%	35%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	3	3
RW Sec SA	15.00%	15.00%
RW ERBA	17.50%	32.50%

Rating	AAA	AA
Underlying	125%	125%
Suboord	35%	30%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	5	5
RW Sec SA	15.76%	24.14%
RW ERBA	20.00%	40.00%

Rating	AAA	AA
Underlying	125%	125%
Suboord	35%	30%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	3	3
RW Sec SA	15.76%	24.14%
RW ERBA	17.50%	32.50%

Rating	AAA	AA
Underlying	150%	150%
Suboord	37%	32%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	5	5
RW Sec SA	N/A	N/A
RW ERBA	20%	40%

Rating	AAA	AA
Underlying	150%	150%
Suboord	37%	32%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	3	3
RW Sec SA	N/A	N/A
RW ERBA	17.50%	32.50%

CLO / RMBS mortgage warehouses

5 years +

Rating	AAA	AA
Underlying	35%	35%
Suboord	18.75%	15.50%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	5	5
RW Sec SA	15.00%	15.00%
RW ERBA	20.00%	40.00%

3 years

Rating	AAA	AA
Underlying	35%	35%
Suboord	18.75%	15.5%
Priority	Senior	Senior
Behavioural		
Maturity		
Years	3	3
RW Sec SA	15.00%	15.00%
RW ERBA	17.50%	32.50%

Annex 3

Data availability issues under CRR 3.1

As indicated above, some of the data required under CRR 3.1 are likely impossible to obtain in a securitisation context. Examples are set out below.

- *Number of properties a borrower holds (CP16/22 p3.164):*

While this has been flagged as a difficulty in the wider Basel3.1 requirements, it is particularly acute in securitisations of third-party assets because the borrower will only be identified by number, and hence reference to external credit reports will not be available. There will be similar difficulties in identifying where repayment is materially depended on the cashflow of a property and where the property is an HMO (CP16/22 p3.161)

- *Social Housing (CP16/22 p3.171):*

Basel 3.1 contains detailed requirements around the strict definition of social housing that will not be recognised by non-CRR institutions, making it difficult for them to identify social housing.

- *Turnover for SMEs:*

This feature is unlikely to be captured by originators and hence makes it difficult to differentiate a corporate and retail split in an underlying pool.

- *Transactor/revolver distinction (CP16/22 p3.128):*

Whether or not an underlying borrower has regularly paid of their borrowing over the year (and according to detailed regulatory definitions that will be new to the originator) will be an unfeasible feature to obtain in investor reporting.

- *Investment Grade/Non-investment Grade:*

If a bank decides to make this distinction, it will be on bespoke criteria with the bank and hence not reasonable to request of a third party on many assets. For example, a bank may choose to base this decision on PD which would absolutely not be in the power of a third party (non CRR) originator to provide. We would suggest in this instance that where banks have chosen the more risk sensitive approach (CP16/22 para 3.96) to assume 100% RW on all underlying assets is not considered 'cherry picking'.

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