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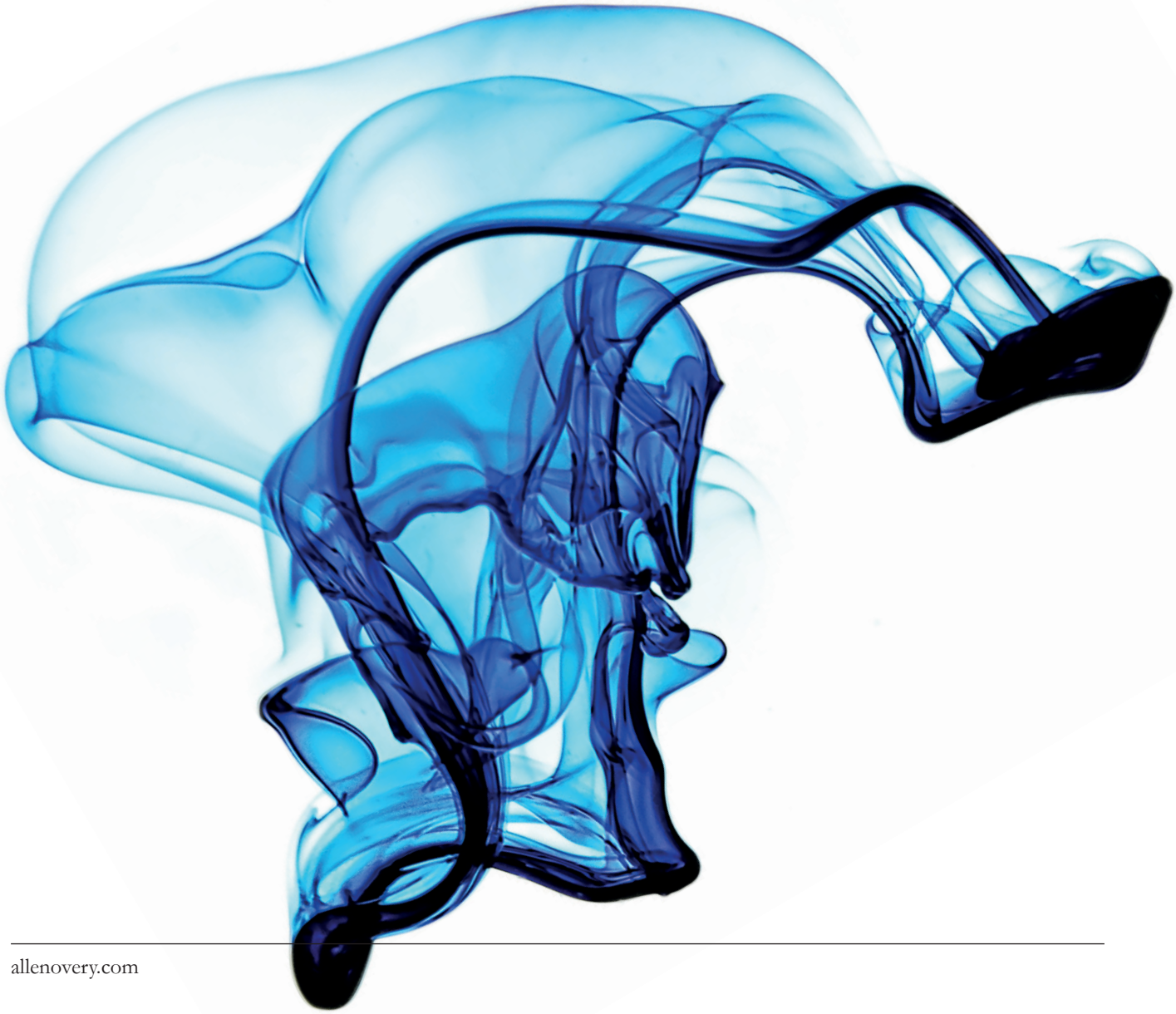
PRA policy statement published on the revised EU securitisation framework and significant risk transfer

December 2018



Introduction and background

On 15 November 2018, the UK Prudential Regulatory Authority (**PRA**) published a policy statement (linked here[1]) setting out certain updated expectations on the part of the PRA with regard to significant risk transfer (**SRT**) securitisation, as well as its proposed approach to implementing certain matters related to revised securitisation capital framework under the EU Capital Requirements Regulation[2] (**CRR**) (as amended by the Securitisation Prudential Regulation[3]) and the coming EU Securitisation Regulation[4]. The policy statement follows a consultation paper (linked here[5]) on the relevant proposals.

The policy statement contains, as appendices, the following supervisory statements: (1) Securitisation: Significant Risk Transfer (linked here[6]); (2) Securitisation: General requirements and capital framework (linked here[7]) (together, these supervisory statements amend and replace the PRA's supervisory statement Securitisation (linked here[8])); and (3) The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)[9] (this is an amended version of an existing supervisory statement).

Save as discussed below, the PRA's consultation proposals, outlined in our previous client bulletin on the consultation paper (linked here[10]), are adopted unchanged.

Different parts of the final guidance are relevant to different firms, depending on whether the guidance relates to the implementation of the Securitisation Regulation, revisions to the CRR securitisation capital framework, or SRT securitisation. Policy relating to the implementation of the Securitisation Regulation is currently relevant to PRA-authorised firms subject to the CRR and Capital Requirements Directive IV[11] (together CRR firms) and PRA-authorised Solvency II[12] firms and is proposed to be extended to all PRA-authorised firms including non-CRR, non-Solvency II firms. Guidance relating to the revision to the banking securitisation capital framework and SRT securitisation is relevant to PRA-authorised CRR firms only. The PRA does not make any proposals regarding the Solvency II securitisation capital framework, but indicated in the consultation that it might decide these were needed following the adoption of proposed amendments to the Solvency II Delegated Regulation Delegated Regulation[13] (which has now occurred).

01_https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2018/ps2918.pdf?la=en&hash=1470980D2245BF3E22F60A0D0E31FBCDE5D5E41C

02_Regulation (EU) No 575/2013

03_Regulation (EU) 2017/2401

04_Regulation (EU) 2017/2402

05_https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp1218.pdf?la=en&hash=51588B96FDD56746BFFEDA17B5553CE657912ABE

06_https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2018/ss913update2-november-2018.pdf?la=en&hash=BC0503363B39A2969ACC88F964A8EE2DF383199C

07_https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2018/ss1018.pdf?la=en&hash=C13DF5925ED2938B01B0AE5F84BF5F30EFAA7581

08_https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2017/ss913update.pdf?la=en&hash=FD812F0A39BFB9AA357A0EA74D431E787551FD50

09_https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2018/ss3115update-november-2018.pdf?la=en&hash=C4AB250282852FA5D2A5894FBDB81F8E66EC12DB

10_http://www.allenovery.com/SiteCollectionDocuments/PRA_consultation_paper_published_on_the_revised_EU_securitisation_framework_and_significant_risk_transfer_(Email).pdf

11_Directive 2013/36 EU https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02013L0036-20180113

12_The Solvency II Directive (2009/138/EC) and the Solvency II Delegated Regulation (2015/35), jointly 'Solvency II'

13_ Delegated Regulation (EU) 2015/35

The FCA has current consultations (linked here[14]) proposing changes to its Handbook necessary to reflect the Securitisation Regulation and related HMT implementing statutory implement[15]. It has not, however, proposed substantive additional/gold-plating guidance akin to that in the PRA policy statement. Given the similarity, in general, of PRA and FCA approach where it relates to the same legislation, the PRA's proposals may, never the less, be of interest to FCA-authorised CRR firms and potentially, in relation to SRT only, FCA-authorised BIPRU firms.

Further, the PRA's policy in relation to SRT (in particular its proposals re (i) excess spread, and (ii) the assessment of commensurate risk transfer for portfolios of exposures on the standardised approach to credit risk) represents a material development in the context of the current European debate around reforms to the SRT regime proposed in the EBA's Discussion Paper on Significant Risk Transfer (linked here[16], the EBA SRT DP). As such, it may be of interest to firms outside the scope of UK prudential regulation that participate in SRT securitisations, their regulators, and, potentially, the EBA in finalising its response to the EBA SRT DP (the EBA has until January 2021 to report back) and any resulting delegated regulation.

14_https://www.fca.org.uk/publication/consultation/cp18-30.pdf and https://www.fca.org.uk/publication/consultation/cp18-22.pdf

15_In very general terms: a large number of conforming changes, the extension of the FCA's enforcement powers to cover unauthorised firms acting as sponsors, originators or Securitisation Special Purpose Entity (SSPEs) in a securitisation, a decision procedure for applications for and withdrawal of authorisation of third party verifiers (TPV) and related regulatory fee structure.

16_https://www.eba.europa.eu/documents/10180/1963391/Discussion+Paper+on+the+Significant+Risk+Transfer+in+Securitisation+%28EBA-DP-2017-03%29.pdf

SRT-related guidance

Excess spread and tranche thickness for standardised approach (SA) portfolios

In the final guidance, the PRA essentially maintains its controversial consultation positions, in respect of SRT deals, re: (i) the treatment of excess spread (though some minor clarifications are made in relation to the treatment of excess spread in traditional securitisations – see below); and (ii) tranche thickness for SA portfolios (though there is a welcome change of emphasis, with the 1.5 x K_{SA} scalar which is applied to set the minimum detachment point (D) for sold tranches, now presented as a "prudent fall-back", where a firm cannot convince the PRA that a lower scalar is required, rather than as the norm). These changes potentially impact the economics of SRT deals for UK-regulated originators.

The PRA states that it will review its SRT-related final guidance in light of any regulation flowing from the EBA's Discussion Paper on Significant Risk Transfer (linked here[17], the **EBA SRT DP**) and rejects characterisation of its guidance as a response to the EBA SRT DP proposals. It will, never the less, be interesting to see whether the PRA's SRT-related guidance (and its guidance regarding the risk-weighting hierarchy), influence the approach taken by other regulators and, in the case of the SRT-related guidance, the EBA.

LGD input to be used for SRT transactions of IPRE portfolios subject to slotting approach

The PRA unhelpfully clarifies that (pending international regulatory clarification) it expects the loss given default (**LGD**) input to the SEC-IRBA for SRT transactions of income producing real estate (**IPRE**) portfolios subject to the slotting approach to be the (conservative) 50% LGD value given in Article 259(6) of the revised CRR, rather than the LGD regulatory inputs as provided in Article 161 of the CRR, which would result in an LGD of either 35% or 45% depending on collateral. No guidance is provided in respect of LGD inputs for other asset classes potentially subject to slotting (or whether the whole portfolio – or merely the slotted exposure – should be subject to the 50% LGD)[18]. This guidance was not consulted on, and represents an adverse response to a question posed in market feedback to the consultation, tallying with the PRA's general assessment that IPRE is a particularly difficult asset class for which to build effective rating systems compliant with the requirements of IRB approach.

Revised CRR securitisation capital framework, ICAAP, additional information requests, and IAA permissions

Guidance regarding the risk weighting hierarchy for securitisation positions (exercise of the PRA's discretion to disallow use of the SEC-IRBA and/or SEC-SA)

The PRA also maintains its controversial consultation position (relevant to all securitisations) regarding the use of its CRR discretions to disallow use of the formulae-based approaches (the Securitisation Internal Ratings Based Approach (**SEC-IRBA**) and Securitisation Standardised Approach (**SEC-SA**)) in the revised securitisation position risk weighting hierarchy. The non-exclusive list of features or characteristics deemed to expose firms to risks not captured in the SEC-SA or SEC-IRBA, and which therefore potentially trigger exercise of discretion, is unchanged. The final guidance does, however, contain helpful clarification to allay market concerns that the PRA intends to – effectively – preclude use of SEC-IRBA or SEC-SA altogether (similar to its approach to current supervisory formula method)/require ECAI ratings for all securitisation positions.

17_https://www.eba.europa.eu/documents/10180/1963391/Discussion+Paper+on+the+Significant+Risk+Transfer+in+Securitisation+%28EBA-DP-2017-03%29.pdf

18_Slotting covers: project finance, real estate, object finance and commodities finance exposures

It remains to be seen whether (in transactions with UK regulated investors) the PRA's guidance impacts transaction structuring in relation to features identified by the PRA as potential triggers for the exercise of its discretion, such as turbo amortisation and investor exposure to residual value risk, and/or whether the uncertainty inherent in the discretions (which can potentially be exercised post-closing, at which point it may be impractical to obtain a rating) results in external ratings[19] being sought on a precautionary basis.

Interim mapping of ECAIs (rating agencies') structured finance credit assessments to credit quality assessments

The PRA has not (as requested by some respondents) extended its interim CQS mapping to include rating scales for all recognised ECAIs (in particular DBRS), but indicates that it considers it implicit that the illustrative mappings are intended to apply to all recognised ECAIs.

ICAAP proposals, additional information requests and IAA permissions

The PRA offers some helpful clarification re the revised ICAAP requirements for securitisations (including to the effect that comparative information in the ICAAP relating to capital requirements under different approaches in the risk-weighting hierarchy is required on an aggregate, rather than transaction-by-transaction, basis).

The PRA also increases the time period for responses to its requests for additional information on securitisations from 20 business days to 30 business days, and confirms that permissions in relation to the internal assessment approach are carried over under the revised CRR risk weighting regime.

Securitisation Regulation

The consultation proposals regarding: (i) general requirements for originators, sponsors, original lenders, securitisation special purpose entities (SSPEs) and institutional investors in respect of new securitisations from the start of 2019, and (ii) firms that intend to sponsor simple, transparent and standardised (STS) securitisations are adopted unchanged, save in one respect. The PRA indicates (in the policy statement) that its final guidance on the general requirements of the Securitisation Regulation has been revised to permit an approach to due diligence under Art 5 SR that is "*proportionate to the risk of the securitisation position*", however, this is not apparent in the text of the revised supervisory statement. We understand this to be an accidental omission

The PRA indicates that further communication will be forthcoming in December 2018 regarding the regulatory notification mechanics for information related to private securitisations under Article 7 of the Securitisation Regulation.

This briefing provides a summary of changes to the consultation paper proposals with respect to each of SRT, the CRR securitisation capital framework, ICAAP, additional information requests and IAA permissions and the Securitisation Regulation, taking each topic in turn. We encourage interested clients to contact us with any questions.

19_In light of Article 8c of the Credit Rating Agencies Regulation at least two ratings are required wherever a rating is solicited for a securitisation instrument

SRT-related guidance

Excess Spread

The final PRA guidance broadly maintains the consultation position. This is, per the EBA SRT DP[20], more onerous than the current CRR position and potentially significant, per market feedback, in terms of its impact on the economics of SRT deals (resulting in a higher cost of protection where excess spread is sold, or less risk weighted asset transfer per £ of protection where excess spread is retained). Market participants suggest that the economic impact is particularly severe for portfolios with high expected losses, however, the PRA indicates, in the policy statement, that it has received insufficient evidence to support this claim.

Synthetic excess spread

The final guidance regarding synthetic excess spread (**SES**) is unchanged: it imposes a capital charge, from now, for all synthetic excess spread. An originator must treat this as an off-balance sheet exposure and deduct or 1,250% risk weight a "*reasoned and prudent estimate of the credit enhancement provided*" akin to a retained first loss tranche. The nominal value of the resulting securitisation position is, presumably (though this is not explicit in the final guidance), intended to be fixed at closing rather than adjusted on an ongoing basis to reflect excess spread expectations (eg in light of pre-payments).

Traditional excess spread

Minor clarifications, only, are made to the consultation proposals regarding traditional excess spread (**TES**). The guidance helpfully clarifies that the PRA's primary concern in relation to TES is the situation where:

(i) securitised assets are not derecognised from an accounting perspective (the consultation made no reference to the assets' accounting treatment); and

(ii) the asset purchase price is less than market value (the consultation presented the situation where the asset purchase price is less than market value as merely one example of problematic TES).

In these circumstances, per the consultation proposal, the originator must treat TES as an off-balance sheet exposure and deduct/1,250% risk-weight a "*reasoned and prudent estimate of the credit enhancement provided*" (as for SES), however, the PRA clarifies that an originator can (in consultation with the PRA) measure the credit enhancement provided by TES otherwise than as a first loss tranche. Presumably, only the excess of the fair value of the securitised exposures over the purchase price need be treated as an off-balance sheet securitisation position.

Drafting changes in the final guidance could be interpreted (hopefully this is not the intention) as indicating that TES is capable of creating an originator securitisation position even absent originator rights to deferred consideration[21].

We have, in general, seen an increased focus on purchase price pricing in traditional securitisations since publication of the EBA SRT DP, originators having gathered that is not necessarily adequate to assume that the discount rate on the principal amount of securitised assets and the assets' coupon net out. The PRA guidance (and the EBA SRT DP) raise questions as to how to establish market value in this context and present particular issues for zero-coupon assets.

20_The EBA SRT DP moots a possible future Pillar 1 capital charge for excess spread, but suggests that this is not a current CRR or Basel requirement.

21_Reference to a requirement for deferred consideration rights is deleted in the discussion of problematic TES in the final guidance and the PRA indicates, in its explanatory statement, that it does not believe its excess spread proposals apply capital requirements to future income,(which, market responses pointed out, would be inconsistent with the general credit risk framework) but rather to the risk retained by firms where excess spread is structured to provide credit enhancement

Double counting concerns in relation to SES and TES

Perhaps unsurprisingly (given that the CRR does not permit this and Basel expressly prohibits this[22]) the PRA indicates that it will not allow investors to benefit, as requested by some market participants, from increased attachment points for further securitisation positions in light of the deemed originator securitisation position for unrealised excess spread. There *is* therefore double counting of capital requirements under the SEC-IRBA and SEC-SA in the sense that the originator and investors both hold capital against the same tranche of risk. The PRA indicates that it may consider adjustment to the post securitisation capital requirement of an originator to reflect double counting, but this presumably only means double counting as between the originator's securitisation position in respect of excess spread and the originator's *own* other retained positions[23].

The prudential filters in Article 32 CRR require an originator to exclude from its own funds any increase in equity under the applicable accounting framework that results from securitisation, including: '*gain on sale*' from '*future margin income*' (under Article 32(1)(a) CRR), and '*net gains*' arising from the '*capitalisation of future income from securitised assets that provide credit enhancement to positions in the securitisation*' (under Article 32(1)(b) CRR). The PRA understands that the Art 32 prudential filters are relevant only in context of assets that are derecognised from an accounting perspective, so that there is no double counting of amounts excluded from capital under Article 32 where the assets are not derecognised from an accounting perspective. A synthetic securitisation will not result in accounting derecognition, and the PRA has now clarified that its concern in relation to TES is limited to situations where there is no accounting derecognition.

PRA states that, as it considers excess spread to be a "*complex feature*", firms "*may*" approach it to discuss potential transactions including this feature ahead of execution as envisaged by paragraph 2.8 of the SRT supervisory statement. However, paragraph 2.8 of the SRT supervisory statement indicates that the PRA "*expects*" transactions with "*complex features to be discussed with the PRA at an early stage*": it is therefore somewhat unclear whether pre-closing discussion of transactions involving excess spread is mandatory or voluntary.

Tranche thickness for securitisations of SA portfolios

The PRA guidance maintains the scalar, proposed in the consultation, of 1.5 x K_{SA} to set the detachment point (D) for sold securitisation tranches in securitisations of standardised approach (**SA**) portfolios. The PRA proposed this scalar on the basis that: an absence of high-quality data can make it harder to establish the appropriate tranche thickness for SA portfolios; and (less sensitive) SA risk weights can understate the risk in respect of certain underlying exposures, in turn overstating the risk transferred to third parties (as well as overstating the risk in respect of other asset classes).

However, the final guidance helpfully clarifies that the 1.5 x K_{SA} scalar is regarded as a "prudent fall-back" and that use of a lower (or presumably no) scalar for the detachment point is possible where a firm can evidence that this is justified. The feedback statement indicates that the PRA will remain flexible in assessing firms' evidence for the reduced scalar to KSA, including use of "*external data sources where comparable and representative*".

It will be interesting to see if consistent practice develops in relation to the application of particular levels of scalar to particular asset classes and whether the level of scalar is affected by the amount of risk that an originator retains below D (the guidance makes no reference to this).

22_PRA flags no scope in Basel or CRR to adjust A and D for other tranches to prevent double counting caused by making originator recognise unrealised excess spread as a 1,250%/deductible securitisation position (this is explicitly prevented in Basel, see Paragraph 55: https://www.bis.org/bcbs/publ/d374.htm).

23_[How interacts with CRR proposal re overcollateralization (New Art. 242(9) "any form of credit enhancement by virtue of which underlying exposures are posted in value which is higher than the value of the securitisation positions"). Does PRA regard value of underlying exposures as being market value or gross book value per EBA SRT DP?]

Introduction and background

LGD input to be used for IPRE portfolios subject to slotting approach

Specialised lending exposures are a specific type of exposure, where the exposure relates to an entity which was created specifically to finance or operate physical assets or is an economically comparable exposure. The contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate and the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise. Within the IRB approach, the CRR allows for a special treatment of specialised lending exposures, in the event that the institution is not able to estimate the Probabilities of Default (PDs) or the institution's PD estimates do not meet the requirements of PD estimation. For these types of exposures, the CRR puts forward a set of supervisory risk weights, which have to be assigned on the basis of a classification in five categories, depending on the underlying credit risk, as well as the remaining maturity. This approach is also known as the supervisory slotting criteria approach for specialised lending exposures.

The PRA unhelpfully clarifies that (pending international regulatory clarification) it expects the LGD input to the SEC-IRBA for SRT transactions of slotted IPRE portfolios to be the (conservative) LGD value provided in Article 259(6) of the revised CRR[18]. This guidance was not consulted on, but represents an adverse response to a question posed in market feedback to the consultation and is in line with the PRA's general assessment that IPRE is a particularly difficult asset class for which to build effective rating systems compliant with the requirements of the IRB approach[24]. The PRA does not indicate what LGD inputs are required for slotted exposures that are not IPRE (slotting covers: project finance, real estate, object finance and commodities finance exposures), or whether, for IPRE exposures, Article 259(6) LGD should apply to the whole reference portfolio, or only to the slotted exposures.

24_Within SEC-IRBA, LGDs are needed to calculate the "p" value, which is key input calculating RWEAs. For certain assets subject to "slotting" under SEC-IRBA, RWAs are derived from a look-up table rather than using regulatory LGD input. These include commercial real estate and project finance assets. Market participants queried whether they are required to use 50% LGD prescribed for granular portfolios under Article 259(6) of the revised CRR (Art 259(6) CRR provides a simplified and conservative way to calculate the effective number of exposures (N) and exposure weighted LGDs where largest underlying exposure is ≤3% of pool), or if they are permitted to use foundation IRB LGD regulatory inputs in Article 161 CRR (ie inputs used by banks that are able to calculate PD for the assets, so do not have to use slotting, but which are not AIRB), which would result in lower LGDs of either 35% or 45% depending on collateral.

Revised CRR securitisation capital framework etc.

Exercise of PRA discretion to disallow use of SEC-IRBA and/or SEC-SA

The consultation paper proposed guidance in relation to circumstances in which the PRA will exercise discretion to disallow use of the formulae-based approaches (the SEC-IRBA and/or SEC-SA) in risk weighting securitisation positions under the revised CRR hierarchy (see our previous client bulletin for a description of the revised CRR risk weighting hierarchy for securitisation positions and the CRR basis for this discretion). The SEC-IRBA is explicitly designed to generate lower capital charges than all of the other approaches; the SEC-SA is also likely, in practice, to generate lower capital charges than the SEC-ERBA, especially in the context of STS securitisations[25].

The PRA proposed that, in determining whether to exercise its discretion to preclude the use of the SEC-IRBA and/or SEC-SA, it will consider: (i) whether the securitisations a firm is exposed to exhibit features which are not explicitly captured in the SEC-SA or SEC-IRBA methods; and (ii) consider the appropriateness of the underlying credit risk weights for the portfolio as reflected in the K_{SA} (broadly, the capital charge determined under the SA for the securitised exposures as if they had not been securitised, K_{SA}) or K_{IRB} (broadly, the capital charges determined under the internal ratings-based approach for the securitised exposures as if they had not been securitised) as applicable. The PRA indicated that, because the SEC-IRBA is sensitive to a wider range of inputs than the SEC-SA, where the presence of a highly complex or risky feature leads the PRA to exercise its discretion to preclude the use of the SEC-IRBA, it is also likely to prohibit the use of the SEC-SA on the grounds that the risk weights under the SEC-SA are not commensurate to the risks posed to the institution.

This would mean that an unrated position for which a rating cannot be inferred (or the IAA used), will attract a 1,250% risk weighting (or deduction from CET1 capital).

The final guidance maintains the consultation position. In particular, the (non-exclusive) list of transaction features that are not captured in the SEC-SA or SEC-IRBA & which potentially trigger exercise of the PRA's discretion is unchanged, as follows:

– interest rate risks or foreign exchange risks which arise due to mismatches between the underlying pool and the issued notes, and which are not adequately hedged;

– features or characteristics which expose holders of securitisation notes to the risk that market conditions at the date of the sale or refinance of underlying exposures result in losses, such as exposure to residual value risk (n.b. regarding residual value risk, that positions in securitisations of auto-loans, auto-leases and equipment leases are, in any case, required by the CRR to be risk weighted using the SEC-ERBA rather than SEC-SA where a rating/inferred rating is available, and the SEC-IRBA cannot be used);

– portfolios which exhibit a high degree of single name, sectoral or geographical credit concentration risk;

– portfolios where the underlying exposures may be highly correlated in the event of stress;

– complex mechanisms which impact the priority of payments, for example the existence of turbo features; and

– for transactions to which the SEC-SA applies, where the characteristics of the underlying portfolio exhibit material dilution risk.

However, some helpful clarification is provided about the PRA's proposed approach. The PRA indicates that it does not: (i) "*favour any single [securitisation position risk weighting] method*" (some market participants had expressed concern that the PRA intended to – effectively – preclude use of

25_See eg the European Banking Authority's January 2014 report on qualifying securitisation Figure 24 (page 104): https://www.eba.europa.eu/documents/10180/950548/EBA+report+on+qualifying+securitisation.pdf

the SEC-IRBA and SEC-SA altogether, similar to its approach to the current supervisory formula method); (ii) intend to "*impose the highest possible risk weight at all times*", or (iii) "*expect firms to solicit ECAI ratings for all of their securitisation positions*" (again market participants had expressed concerns in this respect).

The PRA indicates when considering an exercise of its discretion, it will take into account, among other things, the "*aggregate impact on a firm's overall capital requirements*", and that the conditions for the exercise of national competent authority discretion under CRR Articles 254(4) (in relation to the SEC-SA) and 258(2) (in relation to the SEC-IRBA) must be met before it will exercise its discretion.

As a firm, we have already seen firms attempting to create watch-lists of securitisation transaction features that may trigger exercise of competent authority discretion to disallow use of the SEC-IRBA and/or SEC-SA. It's worth flagging, however, that it's only in the context of the SEC-IRBA that exercise of competent authority discretion to deny use of the method requires the existence of "*highly complex or risky features*"[26]. It's also somewhat unclear whether the list of examples of "*highly complex or risky features*" provided in the CRR SEC-IRBA discretion is intended to be exclusive, and the PRA's list is explicitly non-exclusive. In addition to the transaction features identified in the PRA guidance, PRA indicates it will consider whether the underlying internal ratings-based (**IRB**) or SA capital charge for the securitised assets (which flows through to K_{IRB}/K_{SA}) is appropriate. That brings in a broader universe of concerns relating to the PRA's assessment of the adequacy of the underlying capital requirement for different asset classes (particularly on the standardised approach with its flat risk weights, eg to take extreme example which also affects IRB banks applying a permanent partial standardised approach to these exposures, zero risk weights for EU sovereign exposures). Though it's a useful exercise, there's therefore only so far one can go in identifying a definitive watch-list of problematic features (especially at this stage: it's likely that the issues that competent authorities pick up on will become clearer as new rules bed down).

Interim mapping of ECAIs (rating agencies') structured finance credit assessments to credit quality assessments

The final guidance (in line with the consultation proposal) includes an illustrative mapping of long-term ECAI structured finance credit assessments to CQS steps based on the mapping in the Basel standard. For short-term ratings, the PRA proposes that firms use the short-term rating mapping found in the current Commission ITS on CQS mapping for securitisations under the ratings-based method[27]. The PRA has not extended its interim CQS mapping to cover all ECAIs (in particular, DBRS is not covered). The PRA considers that it is already implicit that the illustrative mapping is intended to apply to all recognised ECAIs and that that including rating scales for all recognised ECAIs is not necessary or practical

26_See Art 258(2) revised CRR. In the context of the SEC-SA, the discretion is exercisable whenever "the risk-weighted exposure amount resulting from the application of the SEC-SA is not commensurate to the risks posed to the institution or to financial stability, including but not limited to the credit risk embedded in the exposures underlying the securitisation", though – for non-STS securitisations – the competent authority is supposed to have "particular regard" to securitisations with "highly complex and risky features".

27_Annex II of Regulation (EU) 2016/1801: https://eur-lex.europa.eu/legal-content/EN/TXT/?toc=OJ:L:2016:275:TOC&uri=uriserv:OJ.L_.2016.275.01.0027.01.ENG

ICAAP proposals and additional information requests

In line with the consultation proposals, the PRA will use firms' reporting in the ICAAP document, as well as information received by regulatory reporting and other means, to determine whether securitisation exposures under SEC-SA or SEC IRBA are appropriately capitalised with various matters mandated for consideration and reporting in firms' ICAAPs in relation to their securitisation positions. The ICAAP requirements potentially involve the calculation of RWEAs under multiple risk weighting methods, identification of risk characteristics and structural features of securitisations not explicitly taken into account in those risk weighting methods, and critical evaluation of ECAI rating methodologies. However, the final guidance helpfully clarifies that:

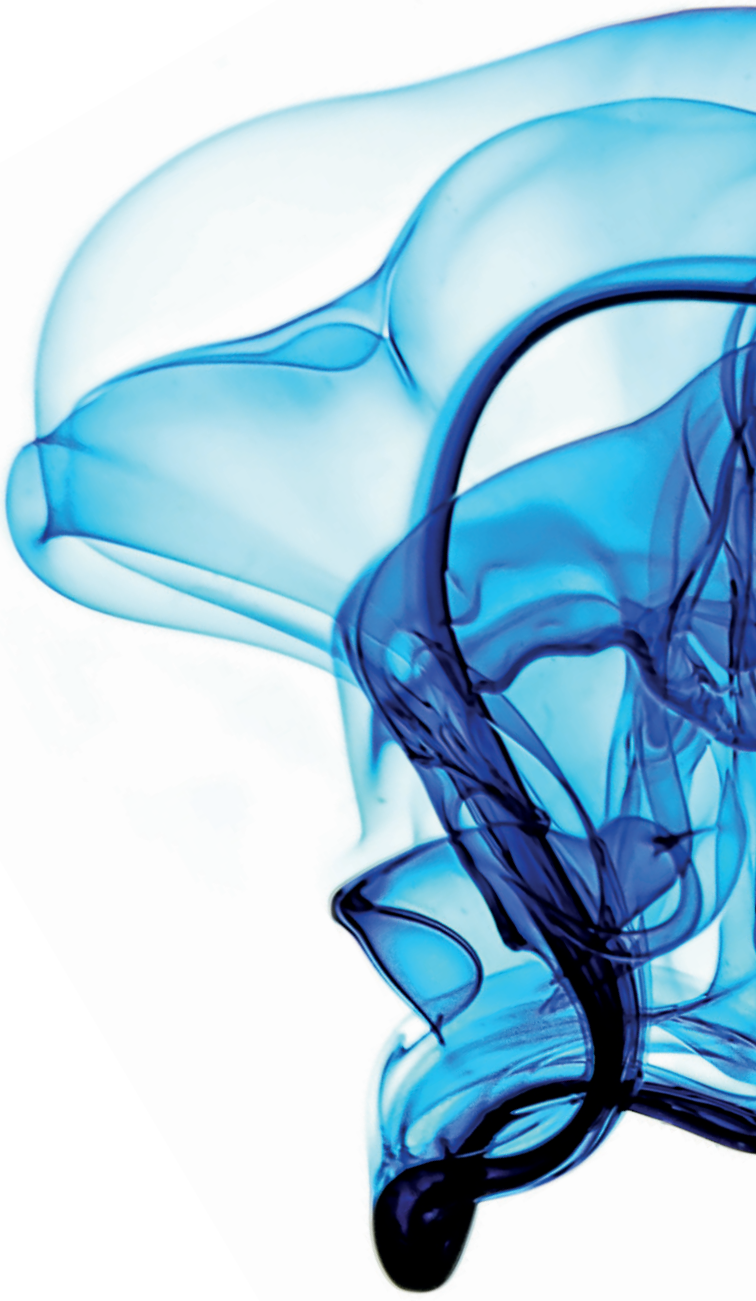
– the comparative information (proposed in the consultation and confirmed in the final guidance) required to be provided in firms' ICAAP documents regarding the capital requirements that would apply under different approaches in the securitisation position risk weighting hierarchy is not required on a deal-by-deal basis, but rather on an aggregate basis (or if relevant an aggregate basis split by asset class, risk characteristic or other feature) (the PRA can, however – as per the consultation proposals – still request calculations on a deal-by-deal basis through additional information requests – see below); and

– risk weight calculation under the SEC-ERBA is only required where a transaction is rated.

Under the final guidance, a firm would have 30 business days (rather than the 20 business days originally proposed) to respond to PRA requests for additional information in order to evaluate whether its Pillar 1 capital requirements appropriately reflect the risks posed by a securitisation.

Internal Assessment Approach permissions

The final guidance helpfully confirms that firms' existing internal assessment approach model permissions carry over under the new regime.



Securitisation regulation

Proportionality of investor due diligence

The consultation paper proposals to clarify the PRA's approach and expectations in relation to: (i) chapter 2 of the Securitisation Regulation, which provides for certain requirements for originators, sponsors, original lenders, securitisation special purpose entities (**SSPEs**) and institutional investors in respect of new securitisations in general from the start of 2019; and (ii) firms that intend to sponsor simple, transparent and standardised (**STS**) asset backed commercial paper programmes in accordance with the new STS regime provided for by the Securitisation Regulation are adopted unchanged, save in one respect relating to due diligence.

In relation to due diligence, the consultation proposals provided that:

– institutional investors which invest in securitisation should be able to demonstrate that they have in place adequate due diligence arrangements, processes and mechanisms to ensure compliance with article 5 (due diligence) of the Securitisation Regulation; and

– a firm that has delegated the authority to manage its investments to another institutional investor may instead evidence that it has instructed the managing party to fulfil the due diligence requirements on its behalf.

The PRA indicates (in the policy statement) that its final guidance on the general requirements of the Securitisation Regulation has been revised to permit an approach to due diligence under Art 5 SR that is "*proportionate to the risk of the securitisation position*", however, this is not apparent in the text of the revised supervisory statement. We understand this to be an accidental omission.

Extension of scope of SS10/18 to cover PRA authorised non-CRR and non-Solvency II firms

Under Article 29 of the Securitisation Regulation and HMT's 4 December 2018 statutory instrument on UK implementation of the Securitisation Regulation[28], the PRA is the competent authority for PRA-authorised persons with respect to the general requirements of securitisations (due diligence, risk retention, disclosure, the ban on re-securitisation, and credit granting[29]). This includes supervision of PRA-authorised persons not covered by the EU legislative acts referred to in Article 29[29] of the Securitisation Regulation, including non-CRR and non-Solvency II firms[31]. The PRA indicates, in the final guidance (published before the statutory instrument, but anticipating the PRA's appointment on this basis), that that the supervisory statement Securitisation: General requirements and capital framework[32]will be updated to apply to such firms (PRA-authorised CRR firms and all PRA-authorised Solvency II firms are already covered).

28_which will enter force on 1 Jan 2019 subject to parliament not taking action to prevent this

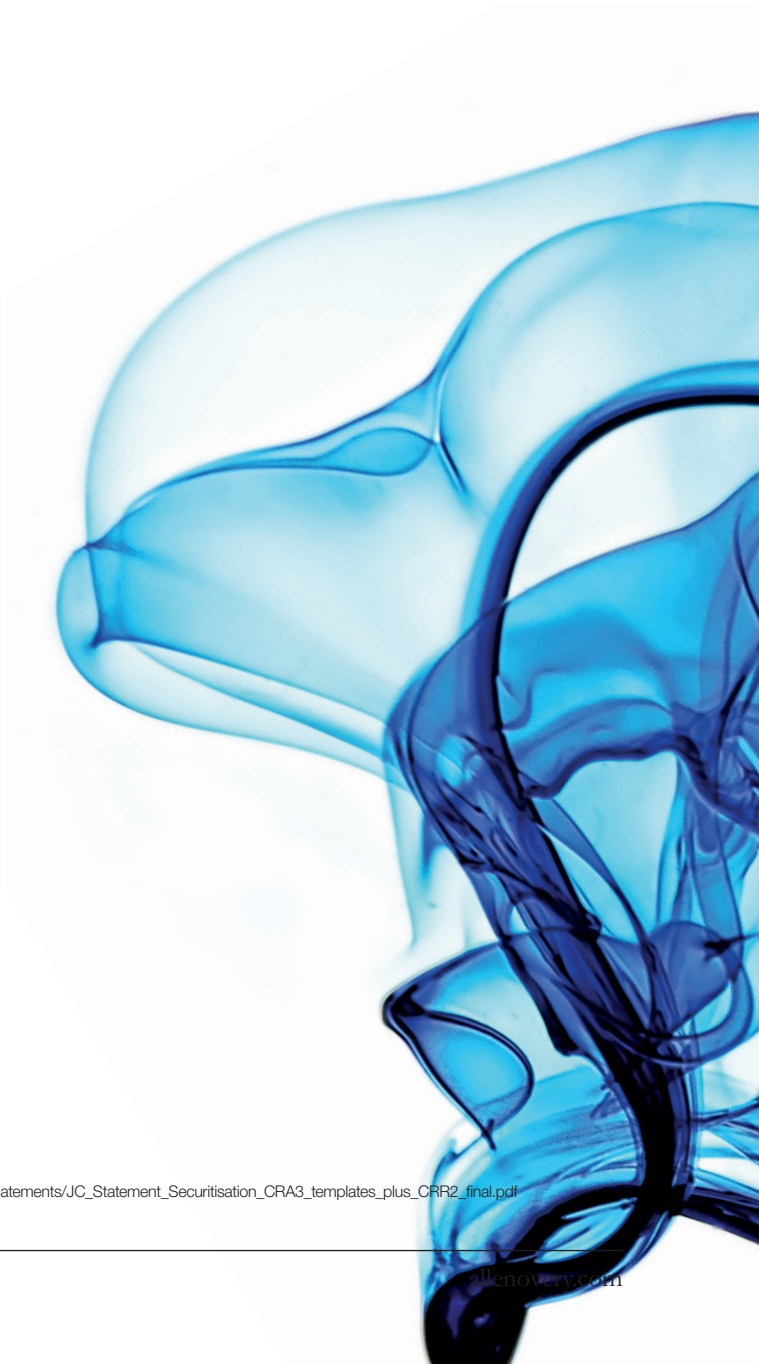
29_under Articles 5, 6, 7, 8 and 9 of the Securitisation Regulation respectively the Securitisation Regulation's due diligence requirements are not, however, relevant to such persons

31_SS10/18

32_Article 1(11) of the Securitisation Prudential Regulation, which replaces, in Article 14 of the CRR, references to Part Five with references to Chapter 2 of the Securitisation Regulation

No guidance provided regarding Article 14 CRR (consolidated scope of general requirements), but PRA subject to ESAs' general guidance

Article 14 CRR applies certain EU securitisation rules to EU-established financial groups on a consolidated basis. It was amended by the Securitisation Prudential Regulation making it much more far-reaching[33]. It has been widely acknowledged that the expansion in scope of Article 14 was an accident and, consequently, amendments to Article 14 have been proposed and are expected to be published in the Official Journal as part of the risk reduction package of CRR2 currently in trilogues. The PRA makes no statement, in the final guidance, with respect to its approach in relation to Article 14 CRR. National competent authorities have, however, have been directed by the Joint Committee of the European Supervisory Authorities[33] to apply their risk-based supervisory powers in a proportional manner in this respect, including taking into account the proposed changes to the scope of Article 14 of the CRR, based on the latest trilogue agreement.



33_in a statement dated 30 November linked here https://esas-joint-committee.europa.eu/Publications/Statements/JC_Statement_Securitisation_CRA3_templates_plus_CRR2_final.pdf

Timing and next steps

In keeping with the general application timing of the Securitisation Regulation and the amended CRR, the PRA proposes to apply the proposals in respect of the implementation of the Securitisation Regulation and the revised CRR securitisation capital framework from 1 January 2019. The PRA's proposals in relation to SRT take effect immediately in relation to all PRA-authorised CRD IV firms as the proposed changes are regarded to be equally applicable to the current and amended CRR regimes.

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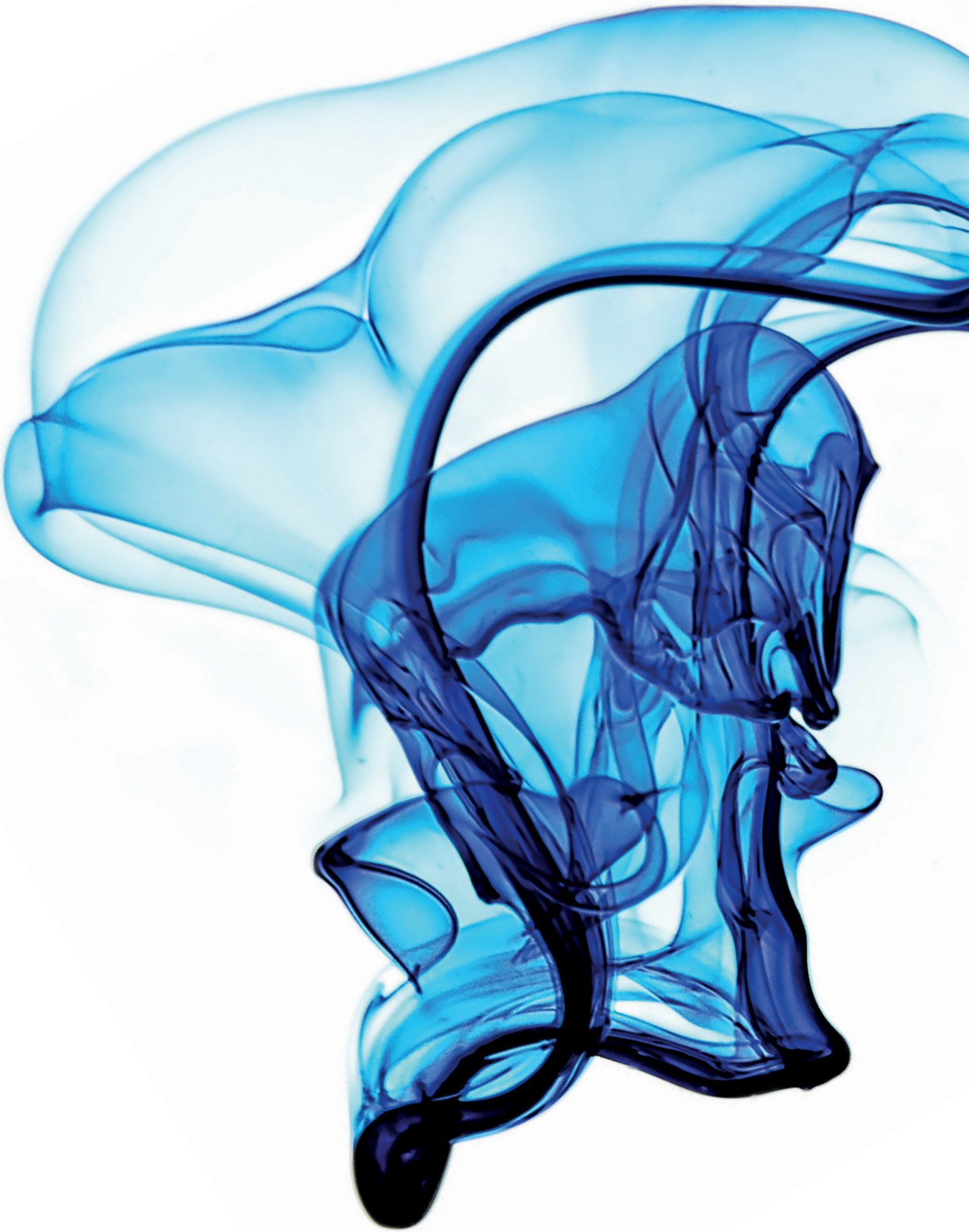

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