

Chapter 9

Securitisation

9.5 Synthetic securitisation

Minimum requirements for recognition of significant credit risk transfer

9.5.1

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(1) An originator of a synthetic securitisation may calculate *risk weighted exposure amounts*, and, as relevant, *expected loss amounts*, for the securitised exposures in accordance with ■ BIPRU 9.5.3 R and ■ BIPRU 9.5.4 R, if either of the following conditions is fulfilled:

- (a) significant credit risk is considered to have been transferred to third parties, either through funded or unfunded credit protection; or
- (b) the originator applies a 1250% risk weight to all securitisation positions he holds in this securitisation or deducts these securitisation positions from capital resources according to ■ GENPRU 2.2.237 R;

and the transfer complies with the conditions in (2)-(8).

[Note: BCD, Annex IX, Part 2, Point 2, paragraph 2]

- (2) The securitisation documentation must reflect the economic substance of the transaction.
- (3) The credit protection by which the credit risk is transferred must comply with the eligibility and other requirements under ■ BIPRU 5 (Credit risk mitigation) and, so far as applicable, ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach) for the recognition of such credit protection. For the purposes of this rule, *securitisation special purpose entities* must not be recognised as eligible unfunded protection providers.
- (4) The instruments used to transfer credit risk must not contain terms or conditions that:
 - (a) impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;
 - (b) allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;
 - (c) other than in the case of *early amortisation provisions*, require positions in the securitisation to be improved by the originator; or
 - (d) increase the originator's cost of credit protection or the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool.

- (5) An opinion must be obtained from qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.

[Note: BCD Annex IX Part 2 point 2]

- (6) Significant credit risk will be considered to have been transferred if either of the following conditions is met:

- (a) the *risk weighted exposure amounts* of the *mezzanine securitisation positions* which are held by the *originator* in this *securitisation* do not exceed 50% of the *risk weighted exposure amounts* of all *mezzanine securitisation positions* existing in this *securitisation*;
- (b) where there are no *mezzanine securitisation positions* in a given *securitisation* and the *originator* can demonstrate that the *exposure* value of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight* exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the *originator* does not hold more than 20% of the exposure values of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% risk weight.

[Note: BCD, Annex IX, Part 2, Point 2, paragraph 2a]

- (7) An *originator* must notify the *appropriate regulator* that it is relying on the deemed transfer of significant credit risk under ■ BIPRU 9.5.1R (6) within a reasonable period before or after a relevant transfer, not being later than one month after the date of the transfer. The notification must include the following information:

- (a) the *risk weighted exposure amount* of the *securitised exposures* and retained *securitisation positions*;
- (b) the *exposure* value of the *securitised exposures* and the retained *securitisation positions*;
- (c) details of the *securitisation positions*, including rating, *exposure* value broken down by *securitisation positions* sold and retained;
- (d) a statement that sets out why the *firm* is satisfied that the reduction in *risk weighted exposure amounts* is justified by a commensurate transfer of credit risk to third parties;
- (e) any relevant supporting documents, for example, a summary of the transaction.

9.5.1A G An *originator* may be granted a *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7).

9.5.1B D An *originator's* application for a *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7) must demonstrate that the following conditions are satisfied:

- (1) it has policies and methodologies in place which ensure that the possible reduction of capital requirements which the *originator* achieves by the *securitisation* is justified by a commensurate transfer of credit risk to third parties; and

- (2) that such transfer of credit risk to third parties is also recognised for the purposes of all the *originator's* internal risk management and its internal capital allocation.

[Note: BCD, Annex IX, Part 2, Point 2, paragraph 2c]

9.5.1C **G** ■ BIPRU 1.3.10 G sets out the *appropriate regulator* approach to the granting of *waivers*. The conditions in ■ BIPRU 9.5.1BD are minimum requirements. Satisfaction of those does not automatically mean the *appropriate regulator* will grant the relevant *waiver*. The *appropriate regulator* will in addition also apply the tests in section 138A (Modification or waiver of rules) of the Act.

9.5.1D **G** When considering an application for a *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7), the *appropriate regulator* may undertake a visit to the *firm* in order to examine the *firm's* risk management and governance arrangements. Before such a visit, the *appropriate regulator* may request information from the *firm* additional or supplementary to that provided in the *waiver* application.

9.5.1E **G** An *originator* should clearly state the scope of the *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7) it is seeking in its application. For example, residential mortgage backed securities may be subdivided into prime and sub-prime with only one sub-category within the scope of the *waiver*. Relevant asset classes may therefore be defined according to a *firm's* internal usage of terms.

9.5.1F **G** In the event that the *appropriate regulator* decides that the possible reduction in *risk weighted exposure amounts* which the *originator credit institution* would achieve by the *securitisation* referred to in ■ BIPRU 9.5.1R (6) is not justified by a commensurate transfer of credit risk to third parties, it will use its powers under section 55J (Variation etc on the Authority's own initiative) of the Act to require the *firm* to increase its *risk weight exposure amount* to an amount commensurate with the *appropriate regulator's* assessment of the transfer of credit risk to third parties.

Originators' calculation of risk-weighted exposure amounts for exposures securitised in a synthetic securitisation

9.5.2 **R** ■ BIPRU 9.5.3 R-■ BIPRU 9.5.8 R apply to the calculation by an *originator* of *risk weighted exposure amounts* for *exposures securitised in a synthetic securitisation*.

9.5.3 **R** (1) In calculating *risk weighted exposure amounts* for the *securitised exposures*, where the conditions in ■ BIPRU 9.5.1 R are met, the *originator* of a *synthetic securitisation* must, subject to the treatment of maturity mismatches set out in ■ BIPRU 9.5.6 R-■ BIPRU 9.5.8 R, use the relevant calculation methodologies set out in ■ BIPRU 9.9-■ BIPRU 9.14 and not those set out in ■ BIPRU 3 (Standardised credit risk) or ■ BIPRU 4 (IRB approach).

(2) For *firms* calculating *risk weighted exposure amounts* and *expected loss* amounts under the *IRB approach*, the *expected loss* amount in respect of such *exposures* must be zero.

(3) For clarity, this paragraph refers to the entire pool of *exposures* included in the *securitisation*.

[**Note:** BCD Annex IX Part 2 point 3 and point 4 (part)]

9.5.4

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Subject to the treatment of maturity mismatches set out in ■ BIPRU 9.5.6 R- ■ BIPRU 9.5.8 R, the *originator* must calculate *risk weighted exposure amounts* in respect of all *tranches* in the *securitisation* in accordance with the provisions of ■ BIPRU 9.9- ■ BIPRU 9.14. For example, where a *tranche* is transferred by means of unfunded credit protection to a third party, the *risk weight* of that third party must be applied to the *tranche* in the calculation of the *originators risk weighted exposure amount*.

[**Note:** BCD Annex IX Part 2 point 4 (part)]

Treatment of maturity mismatches in synthetic securitisations

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■ BIPRU 9.5.6 R- ■ BIPRU 9.5.8 R apply to the treatment of maturity mismatches in a *synthetic securitisation*.

9.5.6

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For the purposes of calculating *risk weighted exposure amounts* in accordance with ■ BIPRU 9.5.3 R, any maturity mismatch between the credit protection by which the *tranching* is achieved and the *securitised exposures* must be taken into consideration in accordance with ■ BIPRU 9.5.7 R- ■ BIPRU 9.5.8 R.

[**Note:** BCD Annex IX Part 2 point 5]

9.5.7

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The maturity of the *securitised exposures* must be taken to be the longest maturity of any of those *exposures* subject to a maximum of five years. The maturity of the credit protection must be determined in accordance with ■ BIPRU 5 (Credit risk mitigation) and, so far as relevant, ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach).

[**Note:** BCD Annex IX Part 2 point 6]

9.5.8

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(1) An *originator* must ignore any maturity mismatch in calculating *risk weighted exposure amounts* for *tranches* appearing pursuant to ■ BIPRU 9.9- ■ BIPRU 9.14 with a *risk weight* of 1250%. For all other *tranches* the maturity mismatch treatment prescribed in ■ BIPRU 5.8 (Maturity mismatches) must be applied in accordance with the following formula:

$$RW^* \text{ is } [RW(SP) \times (t-t^*)/(T-t^*)] + [RW(Ass) \times (T-t)/(T-t^*)]$$

(2) The following apply for the purposes of the formula in (1):

(a) RW^* is *risk weighted exposure amounts*;

(b) $RW(Ass)$ is *risk weighted exposure amounts* for *exposures* if they had not been *securitised* calculated on a pro-rata basis;

- (c) $RW(SP)$ is *risk weighted exposure amounts* calculated under ■ BIPRU 9.6.3 G as if there was no maturity mismatch;
- (d) T is maturity of the underlying *exposures* expressed in years;
- (e) t is maturity of credit protection expressed in years; and
- (f) t^* is 0.25.

[Note: BCD Annex IX Part 2 point 7]