

## Chapter 4

# Capital resources

## 4.2BA Securitisation

### Application

- 4.2BA.1 **R** This section applies to a *firm* carrying on any *home financing* connected to *regulated mortgage contracts* or *home financing and home financing administration* connected to *regulated mortgage contracts* (see ■ MIPRU 4.2.23 R).

### Purpose

- 4.2BA.2 **R** A *firm* must calculate the *risk weighted exposure amounts* for the *securitisation positions* it holds under ■ MIPRU 4.2BA.31 R to ■ MIPRU 4.2BA.53 R.

- 4.2BA.3 **G** Where a *firm* has transferred significant credit risk associated with *securitised exposures* which it has originated under ■ MIPRU 4.2BA.5 R (High-level principles) and has complied with other applicable requirements in this section, it may exclude those *securitised exposures* from the calculation of its *risk weighted exposure amount* and expected loss amounts.

### Organisation

- 4.2BA.4 **G** This section is organised as follows.
- (1) High-level principles (■ MIPRU 4.2BA.5 R to ■ MIPRU 4.2BA.8 G)
  - (2) Systems and controls (■ MIPRU 4.2BA.9 R to ■ MIPRU 4.2BA.16 R)
  - (3) Structural features (■ MIPRU 4.2BA.17 R to ■ MIPRU 4.2BA.22 R)
  - (4) Implied future support (■ MIPRU 4.2BA.23 R to ■ MIPRU 4.2BA.30 R)
  - (5) Calculation of risk weighted exposure amounts (■ MIPRU 4.2BA.31 R to ■ MIPRU 4.2BA.53 R)
  - (6) Disclosure to investors (■ MIPRU 4.2BA.54 R)

### High-level principles

- 4.2BA.5 **R**
- (1) Economic substance: the risk management and capital treatment of a *securitisation* must be determined on the basis of its economic substance and not its legal form.
  - (2) Eligible structures: only standalone *traditional securitisations* are eligible.

- (3) Eligible underlying assets: term assets (e.g. residential mortgages) originated by the *firm* are eligible.
- (4) Effective credit-risk transfer: the *securitisation* mechanism (e.g. true sale) must effectively transfer the risks of the *securitised exposures* to the holders of the *securitisation positions*, except those risks that remain adequately covered by the *firm's* capital. The securities issued must not represent payment obligations of the *firm*.
- (5) Significant credit risk transfer: the proportion of risk transferred must be commensurate with, or exceed, the proportion by which *risk weighted exposure amounts* are reduced.
- (6) Implied future support: a *firm* must not provide any support (direct or indirect) to investors in the *securitisation* beyond the *firm's* contractual obligations, with a view to reducing potential or actual losses, unless permitted in ■ MIPRU 4.2BA.27 R.
- (7) Maximum regulatory capital: the maximum regulatory capital requirement for retained *securitisation exposure* is the lowest of:
  - (a) the regulatory *capital resources requirement* plus expected losses for the *securitised exposures* before entering into the *securitisation*; or
  - (b) the *capital resources requirement* from the application of a *risk weight* of 1250% to the retained *securitisation positions*; or
  - (c) deduction of the retained *securitisation positions* from *capital resources*.

4.2BA.6 **G** Eligible structures exclude, for example, structures such as master trusts, synthetic securitisations and asset-backed commercial paper programmes. Financial derivatives (e.g. interest-rate swaps) used to structure the *securitisation* should be with third-party counterparties, not the *firm* or connected entities.

4.2BA.7 **G** Eligible underlying assets would exclude, for example, assets purchased from third-party entities, those arising from re-securitisations and any revolving *exposures* such as credit cards.

4.2BA.8 **G** Further provisions on implied future support are contained in ■ MIPRU 4.2BA.23 R to ■ MIPRU 4.2BA.30 R.

### Systems and controls

4.2BA.9 **R** Policies and procedures: a *firm* must evaluate and address all risks, including reputational risks, through appropriate policies and procedures, to ensure in particular that the economic substance of the transaction is fully reflected in risk assessments and management decisions.

4.2BA.10 **R** Monitoring: a *firm* must continuously monitor risks that it may be subject to when it has excluded the *securitised exposures* from its calculation of *risk weighted exposure amounts*.

- 4.2BA.11 **R** Exposure quality: a *firm* must consider the impact that *securitisation* has on the quality of the remaining *exposures* it holds and the capital planning implications.
- 4.2BA.12 **R** Stress testing: the *firm* must carry out regular stress testing which takes into account:
- (1) the *firm*-wide impact of *securitisation* activities and *exposures* in stressed market conditions; and
  - (2) the implications for other sources of risk including, but not limited to, credit risk, concentration risk, counterparty risk, market risk, liquidity risk and reputational risk.
- 4.2BA.13 **G** Stress testing of *securitisation* activities should take into account both existing *securitisations* and pipeline transactions, as there is a risk that the latter would not be completed in a stressed market scenario.
- 4.2BA.14 **G** The frequency and extent of the stress testing should be determined by the materiality of the *firm's* *securitisation* activities. A *firm* should have procedures in place to assess and respond to the stress-testing results.
- 4.2BA.15 **R**
- (1) Credit-granting: a *firm* must apply the same sound and well-defined criteria used under **SYSC 7.1.9 R** for credit-granting in respect of *exposures* held on the balance sheet to *exposures* to be *securitised*.
  - (2) These criteria must include the processes for approving and, where relevant, amending, renewing and re-financing credits.
- 4.2BA.16 **R** Legal opinions: legal opinions obtained in the context of *securitisation* transactions must be reviewed by an independent legal adviser periodically, or when there is a change in law (including case law) or any applicable rules that may affect the opinion.
- Structural features**
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- 4.2BA.17 **R** The transferee must be a *securitisation special purpose entity*.
- 4.2BA.18 **R** A *firm* must not maintain effective or indirect control over the transferred *exposures*.
- 4.2BA.19 **G** For the purposes of **MIPRU 4.2BA.18 R**, a *firm* will be considered to have maintained effective control over the transferred *exposures* if:
- (1) it has the right to repurchase previously transferred *exposures* to realise their benefits; or
  - (2) it is required to re-assume any previously transferred risk.

4.2BA.20 **G** For the purposes of **■** MIPRU 4.2BA.18 R, the *originator's* retention of servicing rights or obligations in respect of the *exposures* does not, of itself, constitute indirect control of the *exposures*.

4.2BA.21 **R** A *clean-up call option* must satisfy all of the following conditions:

- (1) it must be exercisable at the discretion of the *firm*;
- (2) it must only be exercised when 10% or less of the original value of the *exposures* securitised remains unamortised;
- (3) it must not be structured so that allocating losses to *credit enhancement* positions or other positions held by investors can be avoided; and
- (4) it must not otherwise be structured to provide *credit enhancement*.

4.2BA.22 **R** The *credit enhancement* documentation must not contain clauses that require *securitisation positions* to be improved by the *firm* in response to a deterioration in the credit quality of the *securitised exposures*, including:

- (1) altering the credit quality of the underlying *exposures*; or
- (2) increasing the yield payable to investors in the *securitisation positions*.

#### Implied future support

4.2BA.23 **R** The *securitisation* documentation must make clear, where applicable, that any repurchase of *securitised exposures* or *securitisation positions* by the *firm* beyond its contractual obligations is not mandatory and may only be made at fair market value.

4.2BA.24 **R** In general, any such repurchase must be subject to the *firm's* credit-granting process, which should be adequate to ensure that the repurchase does not provide support.

4.2BA.25 **R** If a *firm* repurchases *securitised exposures* or *securitisation positions*, it must:

- (1) be able to demonstrate that it has adequately considered the following:
  - (a) the price of the repurchase;
  - (b) the *firm's* capital and liquidity position before and after repurchase;
  - (c) the performance of the *securitised exposures*; and
  - (d) the performance of the *securitisation positions*;
- (2) have concluded, taking into account the factors in (1) and any other relevant information, that the repurchase is not structured to provide support; and

- (3) keep adequate records of the considerations and conclusions under (1) and (2).
- 4.2BA.26 R** A *firm* must consider at least the following situations to determine whether there may be a breach of the prohibition against implied future support in ■ MIPRU 4.2BA.5R (6):
- (1) support given under a contractual obligation;
  - (2) support which is not provided for under the contractual documentation for the *securitisation*; and
  - (3) support given under the contractual documentation for the *securitisation* which the *firm* is entitled, but not obliged, to give.
- 4.2BA.27 R**
- (1) The support described in ■ MIPRU 4.2BA.26R (1) is permitted.
  - (2) The support described in ■ MIPRU 4.2BA.26R (2) is not permitted.
  - (3) The support described in ■ MIPRU 4.2BA.26R (3) is permitted if the following conditions are met:
    - (a) contractual and marketing documents of the *securitisation* expressly envisage and allow for the possibility of the *firm* providing such support;
    - (b) the nature of any support that the *firm* may give is precisely described in the contractual and marketing documents of the *securitisation*;
    - (c) both the *firm* and a *person*, whose only information comes from the marketing documents, must be able to ascertain at the time of the *securitisation* the maximum amount of support that can be given in future;
    - (d) an assessment has been made by the *firm* of significant risk transfer, that must include the maximum possible contractual support; and
    - (e) the *firm's capital resources* and *capital resources requirement* are adjusted at the time of the *securitisation* on the basis that the *firm* has provided support to the maximum amount possible, whether by an immediate deduction from *capital resources* or appropriate *risk weighting*.
- 4.2BA.28 G** A waiver of the right to future margin income will not breach the prohibition against implied future support in ■ MIPRU 4.2BA.5R (6) provided that:
- (1) the degree of support that can be given can be defined precisely by reference to the contractual documentation for the *securitisation*, even if the amount of support may not be ascertainable in absolute monetary terms; and
  - (2) no adjustment to the *firm's capital resources* or *capital resources requirement* is required, as a *firm* should not include future margin income in its income or *capital resources*.

**4.2BA.29** **G** If a *firm* is found to have provided support to a *securitisation* this implies that the *firm* may be likely to provide future support to its *securitisations*, thus failing to achieve a significant transfer of risk. The *FCA* will consider taking appropriate measures to reflect this increased expectation after any instance of support is found.

**4.2BA.30** **R** If a *firm* is found to have provided support to a *securitisation* it will be required to:

- (1) hold *capital resources* against all of the *securitised exposures* associated with the *securitisation* transaction as if they had not been securitised; and
- (2) disclose publicly in a timely fashion:
  - (a) where it has provided such support; and
  - (b) the regulatory capital impact of doing so.

#### Calculation of risk weighted exposure amounts

**4.2BA.31** **R** The *risk weighted exposure amount* equals the on-balance sheet *exposure* value multiplied by the *risk weight* associated with the *credit quality step* with which the credit assessment of that *exposure* value is associated.

**4.2BA.32** **R** Where there is an *exposure* to different *tranches* in a *securitisation*, the *exposure* to each *tranche* must be considered as a separate *securitisation position*.

**4.2BA.33** **R** The providers of credit protection to *securitisation positions* must be treated as holding positions in the *securitisation*.

**4.2BA.34** **R** *Securitisation positions* include *exposures* to a *securitisation* arising from interest rate or currency derivative contracts.

**4.2BA.35** **R** The *ECAI* rating of a *securitisation position* must, at a minimum, comply with the following:

- (1) there must be no mismatch between the types of payments reflected in the credit assessment and the types of payment to which the *firm* is entitled under the contract giving rise to the *securitisation position* in question;
- (2) the rating must be publicly available to the market; and
- (3) the rating must not be based, or partly based, on support provided by the *firm* itself.

**4.2BA.36** **G** Credit assessments may only be treated as publicly available under **MIPRU 4.2BA.35R (2)** if they have been published in a publicly accessible forum and they are included in the *ECAI's* transition matrix; a rating that is

only made available to a limited number of entities may not be treated as publicly available.

**4.2BA.37** **G** ■ MIPRU 4.2BA.35R (3) refers, for example, to situations where a *firm* holds *securitisation positions* which receive a lower *risk weight* by virtue of credit protection provided by the *firm* itself acting in a different capacity in the *securitisation* transaction.

**4.2BA.38** **R** The assessment of whether a *firm* is providing unfunded support to its *securitisation* positions must take into account the economic substance of that support in the context of the overall transaction and any circumstances in which the *firm* could become exposed to a higher credit risk in the absence of that support. In this case the *firm* must consider the relevant position as if it were not rated and must apply the relevant treatment for unrated positions.

### Multiple credit assessments for a rated position

**4.2BA.39** **R** Where a *rated position* has credit assessments from two *nominated ECAs*, the *firm* must use the less favourable credit assessment.

**4.2BA.40** **R** Where a *rated position* has more than two *nominated ECAI* credit assessments, the two most favourable credit assessments must be used. If the two most favourable credit assessments are different, the less favourable of the two must be used.

**4.2BA.41** **R** Where eligible credit protection under ■ MIPRU 4.2C (Credit risk mitigation) is provided directly to the *securitisation special purpose entity* and that protection is reflected in the credit assessment of a position by a *nominated ECAI*, the *risk weight* associated with that credit assessment may be used. Where the credit protection is not provided to the *securitisation special purpose entity* but provided directly to a *securitisation position*, the credit assessment must not be recognised

### Minimum operational requirements

**4.2BA.42** **R** A *firm* must attribute to an unrated *position* an inferred rating equivalent to the rating of those *rated positions* (the reference positions) which are the most senior positions and are, in all respects, subordinate to the unrated *securitisation position* in question when the following minimum operational requirements are satisfied:

- (1) the reference positions must be subordinate in all respects to the unrated *securitisation position*;
- (2) the maturity of the reference positions must be equal to or longer than that of the unrated position in question; and
- (3) on an ongoing basis, any inferred rating must be updated to reflect any changes in the credit assessment of the reference positions.



**4.2BA.43 R** Where publicly available credit assessments for *securitisation positions* are available from *eligible ECAs*, a *firm* must:

- (1) nominate one or more of the *eligible ECAs*;
- (2) use the credit assessments of *nominated ECAs* in the calculation of its *risk weighted exposure* amounts under this section; and
- (3) apply those credit assessments consistently in respect of its *rated positions*.

**4.2BA.44 R** Where a *firm* holds a *rated position* it must use the credit assessment from the *nominated ECAs* to determine the *risk weight* for the position using:

- (1) the table in ■ MIPRU 4.2E.14 R to determine the *credit quality step* associated with that credit assessment; and
- (2) the table in ■ MIPRU 4.2BA.45 R to determine the *risk weight* to be applied to the rated position, based on the associated *credit quality step*.

**4.2BA.45 R** Table: Rated positions in securitisations for which a credit assessment by a nominated ECAI is available

This table belongs to ■ MIPRU 4.2BA.44 R.

Credit quality step	1	2	3	4	Other credit quality steps
<i>Securitisation positions</i>	20%	50%	100%	350%	1250%
<i>Resecuritisation positions</i>	40%	100%	225%	650%	1250%

**Concentration ratio approach for unrated securitisation positions**

**4.2BA.46 R** When calculating its *risk weighted exposure amount* for *securitised positions*, subject to satisfying the conditions in ■ MIPRU 4.2BA.47 R, a *firm* may apply the weighted-average *risk weight* that would be applied to the *securitised exposures* multiplied by a concentration ratio.

**4.2BA.47 R** The use of the concentration ratio approach for unrated *securitisation positions* is only permitted where all the following conditions are met:

- (1) the concentration ratio is equal to the sum of the nominal amounts of all the *tranches* divided by the sum of the nominal amounts of the *tranches* junior to, or equal to, the *tranche* in which the position is held, including that *tranche* itself;

- (2) where the resulting *risk weight* for a *securitisation position* is lower than any *risk weight* applicable to a more senior *tranche* than that higher *risk weight* must be applied to the *securitisation position*;
- (3) the composition of the pool of *securitised exposures* is known at all times;
- (4) the *firm* must be able, at all times, to calculate accurately the *risk weighted exposure amounts* of the pool of *securitised exposures* based on its knowledge of the composition of the pool;
- (5) any change to the composition of the pool of *securitised exposures* during the life of the transaction that would lead to an increase in the total *risk weighted exposure amount* of the pool, using the *risk weights* specified in ■ MIPRU 4.2F (Exposures and risk weights), is either
  - (a) prohibited by the documentation; or
  - (b) included in the *firm's* calculation of its *capital resources*.

**4.2BA.48** **G** It is sufficient for the purposes of ■ MIPRU 4.2BA.47R (4) for the composition of the pool of *securitised exposures* to be reported to the *firm* at least daily through information service providers, secure websites or other appropriate sources.

**4.2BA.49** **R** Where the *firm* is unable to determine the *risk weights* that would be applied to the *securitised exposures*, it must apply a *risk weight* of 1250%.

#### Conversion factor for unrated liquidity facilities

**4.2BA.50** **R** (1) A conversion factor of 100% must be applied to the nominal amount of unrated liquidity facilities unless the conditions in ■ MIPRU 4.2BA.51 R or ■ MIPRU 4.2BA.53 R for a conversion factor of 50% or 0% are met.

(2) The *risk weight* to be applied is the highest *risk weight* that would be applied to any of the *securitised exposures* by a *firm* holding those *exposures*.

**4.2BA.51** **R** (1) A conversion factor of 50% may be applied to the nominal amount of an unrated liquidity facility where all the conditions in ■ MIPRU 4.2BA.52 R are met.

(2) The *risk weight* to be applied is the highest *risk weight* that would be applied to any of the *securitised exposures* by a *firm* holding those *exposures*.

**4.2BA.52** **R** The conditions for the application of a conversion factor of 50% are:

(1) the liquidity facility documentation must clearly identify and limit the circumstances under which the facility may be drawn;

- (2) it must not be possible for the facility to be drawn so as to provide credit support by covering losses already incurred at the time of drawdown, for example by providing liquidity for *exposures* in default at the time of drawdown or by acquiring assets at more than fair value;
- (3) the facility must not be used to provide permanent or regular funding for the *securitisation*;
- (4) repayment of drawdowns on the facility must not be subordinated to the claims of investors, other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;
- (5) it must not be possible for the facility to be drawn after all applicable *credit enhancements* from which the liquidity facility would benefit are exhausted; and
- (6) the facility must include a provision that results in an automatic reduction in the amount that can be drawn by the amount of *exposures* that are in *default*.

**4.2BA.53** **R** A conversion factor of 0% may be applied to the nominal amount of an unrated liquidity facility where the following conditions are met:

- (1) the conditions for a conversion factor of 50% in **■** MIPRU 4.2BA.52 R are met;
- (2) the liquidity facility is unconditionally cancellable; and
- (3) repayment of any drawings on the facility are senior to any other claims on the cashflows arising from the *securitised exposures*.

#### Disclosure to investors

**4.2BA.54** **R** A *firm* must ensure that investors have access to all materially relevant data determined as at the date of the *securitisation* and, where appropriate due to the nature of the *securitisation*, thereafter. These data must include:

- (1) the credit quality, performance, cashflows and supporting collateral of the *securitisation exposures*; and
- (2) information necessary to conduct comprehensive and well-informed stress tests on the cashflows and collateral values supporting the *securitisation exposures*.