

**EBA REPORT ON SIGNIFICANT RISK
TRANSFER IN SECURITISATION
UNDER ARTICLES 244(6) AND 245(6)
OF THE CAPITAL REQUIREMENTS
REGULATION**

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EBA

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Abbreviations and Glossary

A-IRB	advanced internal rating based
ABCP	asset-backed commercial paper
BCBS	Basel Committee on Banking Supervision
CA	competent authority
CET1	Common Equity Tier 1
CMBS	commercial mortgage-backed security
COREP	Common Reporting framework
CRA	credit risk adjustment
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CRT	commensurate risk transfer
ECL	expected credit loss
EBA	European Banking Authority
EEVES	equivalent exposure value of excess spread
EL	expected loss
EL_{BE}	expected loss best estimate
F-IRB	foundation internal ratings based
GBV	gross book value
GL	guidelines
ICAAP	internal capital adequacy assessment process
IFRS	international financial reporting standards
IRB	internal ratings based
K_A	capital charge of the underlying pool adjusted by the ratio of underlying exposures in default for the purpose of SEC-SA
K_{IRB}	capital charge determined under the internal ratings based approach for the securitised exposures as if they had not been securitised including the expected loss
LGD	loss given default
LGDD	loss given default in default
LTEL	lifetime expected loss
NPE	non-performing exposure

NRPPD	non-refundable purchase price discount
PBA	principle-based approach
PD	probability of default
P&L	profits and losses
RTS	regulatory technical standards
RWEA	risk-weighted exposure amount
SA	standardised approach
SCRA	specific credit risk adjustment
SEC-ERBA	securitisation external ratings based approach
SEC-IRBA	securitisation internal ratings based approach
SEC-SA	securitisation standardised approach
SES	synthetic excess spread
SRT	significant risk transfer
SRT DP	EBA Discussion Paper on the Significant Risk Transfer in Securitisation
SSPE	securitisation special purpose entity
STS	simple, transparent and standardised
UL	unexpected loss
UIOLI	use it or lose it
WAL	weighted average life
WAM	weighted average maturity

1. Executive summary

1. This report has been prepared in accordance with the mandate laid down in Articles 244(6) and 245(6) of the Capital Requirements Regulation (CRR). Taking into account the findings of the Discussion Paper on the Significant Risk Transfer in Securitisation (SRT DP) of September 2017¹, as well as further analysis, this report includes a set of detailed recommendations to the European Commission on the harmonisation of significant risk transfer (SRT) assessment practices and processes.
2. The report focuses on the three key subject areas singled out by the SRT DP where inconsistencies were found and in relation to which greater harmonisation of both supervisory practices and processes would markedly contribute to enhancing the efficiency and consistency of supervisory SRT assessments within the current securitisation framework. These areas are the structural features of securitisation transactions, the SRT tests and the assessment process.

Structural features of securitisation transactions

3. The review of market and supervisory practices on SRT reported on in the SRT DP revealed six 'structural features' that may cast doubt on the ability of a given transaction to meet SRT conditions: (i) pro rata amortisation structure, (ii) certain call options, (iii) certain other early termination clauses, (iv) excess spread, (v) cost of credit protection and (vi) credit events.
4. To strengthen the level playing field in the supervisory assessment and to improve the transparency and predictability of the SRT assessment by the competent authorities (CAs), the report recommends the following:
 - a) Securitisation transactions that exhibit ineligible structural features should not qualify for SRT recognition. Ineligible structural features could include (i) call options other than those specified in this report and (ii) early termination clauses other than those specified in this report.
 - b) Securitisation transactions that exhibit one or several of the other structural features outlined in this report should comply with a set of safeguards to qualify for SRT recognition and to be eligible for the fast-track SRT assessment process.
 - c) The originator should submit within its risk transfer self-assessment to the CA a quantitative analysis of how the structural features interact in the context of the transaction and affect the risk transferred to the third parties.

¹ EBA Discussion Paper on Significant Risk Transfer in Securitisation, September 2017; see <https://eba.europa.eu/regulation-and-policy/securitisation-and-covered-bonds/discussion-paper-on-the-significant-risk-transfer-in-securitisation>

SRT tests

5. The CRR uses two sets of tests to measure SRT. The mezzanine and the first-loss tests use quantitative formulae to assess the 'significance' of risk transfer. The SRT DP revealed important limitations in the SRT tests.
6. To address those limitations, the report recommends:
 - a) supplementing the first-loss test with a requirement that the first-loss tranche has a minimum thickness; and
 - b) providing for the following two new commensurate risk transfer tests (CRT tests):
 - i. a principle-based approach (PBA) test whereby a minimum of 50% of the regulatory unexpected losses (ULs) of the underlying portfolio should be transferred to third parties;
 - ii. a quantitative test that would measure the commensurateness of the risk transfer.
7. These recommendations are intended to provide CAs and originators with a simple, harmonised and standardised framework that reduces the scope for differing interpretations of the current tests and, thus, enhances the consistency and robustness of the SRT assessment.

SRT assessment process and standard documentation

8. The report sets out recommendations for the harmonisation of the SRT assessment processes and documentation to address the risk of inconsistent outcomes. These recommendations aim to facilitate and speed up supervisory decision-making on SRT, without compromising the quality and thoroughness of the CAs' assessment or their ability to use their judgement, in particular on transactions that are more complex.
9. SRT assessments should be subject to a common supervisory dual-track process, whereby 'qualifying securitisations' would follow a distinctive fast track, while CAs would be able to apply a longer and more in-depth process to the assessment of 'non-qualifying securitisations' (structural features review).
10. Lastly, the report recommends harmonising the preliminary SRT notice that originators should submit to the CA to start the assessment process, as well as the transaction documents that should be made available to the CA to substantiate the assessment.

Recommended amendments to the CRR

11. The majority of the recommendations laid down in the report are specifically intended for implementation within the current CRR, namely through the Commission's delegated act referred to in Articles 244(6) and 245(6) of the CRR.
12. The EBA has also identified some shortcomings in the current CRR provisions on SRT that are significantly detrimental to the effectiveness of this framework. To contribute to further improvements of the SRT framework, the report includes several recommendations on amendments to the CRR.

2. Background

2.1 Mandate and nature of this report

13. This report has been prepared in accordance with the mandate laid down in Articles 244(6) and 245(6) of the CRR. It includes the outcome of the EBA's monitoring of existing practices relating to SRT and a set of recommendations addressed to the European Commission on further harmonisation of the SRT regulatory framework. The Commission may, having taken into account this report, adopt a delegated act to supplement the CRR provisions, based on the mandate in Articles 244(6) and 245(6).

2.2 Significant risk transfer: rationale and purpose

14. Originator credit institutions typically execute securitisations with various objectives in mind. In most cases, however, the primary objective is to transfer all or part of the credit risk embedded in a portfolio of exposures to third parties.
15. From a regulatory capital perspective, the CRR acknowledges that the transfer of credit risk through securitisations may entitle the originator to capital relief, that is, a reduction in the capital requirements that the originator held on the securitised exposures prior to executing the securitisation where it retains part of that risk as a position in the securitisation. The achievement of capital relief in these cases, however, is subject to meeting certain conditions.
16. The framework laid out in the CRR to govern the capital relief that results from securitisations is normally referred to as 'significant risk transfer' (SRT). The key tenet of this framework is that, other than a full transfer of the entire risk of the portfolio, any partial transfer of risk must be:
 - a) 'significant', that is, the originator must transfer a certain minimum amount of the underlying pool's risk and, accordingly, the positions in the securitisation that it retains must not exceed certain pre-defined quantitative thresholds;
 - b) 'commensurate', that is, even if the transfer of credit risk meets the minimum threshold to qualify as 'significant', the reduction in the originator's pre-securitisation capital requirements should be truly reflective of the amount of credit risk transferred to third parties (in other words, there should be no material risk of undercapitalising the originator's retained exposures to the securitisation); and
 - c) 'effective', that is, there should be a genuine transfer of the ownership over the securitised exposures (for traditional securitisations) and of the credit risk associated with them (for both

traditional and synthetic securitisations), in such a manner that the originator is not obliged to reacquire that ownership or reassume that credit risk.

17. These hurdles exist as a test for the originator to pass where it seeks to retain an ongoing exposure to its own securitisation and that such exposure be treated for regulatory capital purposes in the same manner as that of a third-party investor in the securitisation. Hence, the SRT framework's primary purpose is to deliver a genuine 'clean break' for the originator from its position as such in the securitisation, in such a way that minimises the risk of the originator reassuming part of the securitisation's underlying risk initially deemed as transferred to third parties and for which it would no longer hold regulatory capital.
18. With the above in mind, the CRR provides for a supervisory framework to assess the conditions for the transfer of credit risk by originators in securitisations and to ensure that any such transfer meets the conditions of significance, commensurateness and effectiveness. The supervisory SRT assessment verifies that the capital relief sought by the originator is not only consistent with the requirements in legislation but also justifiable by reference to the economic substance of each specific transaction. A capital relief that failed to meet these conditions would weaken the originator's capital position. Hence, the ultimate objective of the supervisory SRT assessment framework is to protect the safety and soundness of the originator, as well as the integrity of and confidence in the market.
19. The CRR allows both traditional and synthetic transactions to achieve SRT. In fact, achieving SRT is one of the key objectives of most synthetic transactions, but the matters laid out in this report are equally relevant to traditional securitisation transactions².

2.3 SRT regulatory framework

20. The SRT regulatory framework is laid out in Articles 244 and 245 of the CRR³ and the EBA guidelines (GL) on SRT, which have been applicable since July 2014⁴. Some CAs have developed additional guidance and supplementary supervisory frameworks for SRT assessments to supplement the EBA GL⁵.

2.3.1 SRT requirements in the CRR

21. The CRR allows the originator of a securitisation transaction to exclude the securitised exposures from the calculation of its regulatory capital requirements and, instead, hold capital only in respect of the positions (tranches) it retains in the transaction in accordance with the securitisation chapter of the CRR if either of the following conditions is met:

² For further information on SRT market practices, see Section 2.1 of the EBA SRT DP: [Link](#)

³ Article 244 applies to traditional securitisations and Article 245 applies to synthetic securitisations.

⁴ EBA/GL/2014/05: [Link](#)

⁵ For further information on supervisory practices on SRT, see Section 2.2 of the EBA SRT DP: [Link](#)

- a) significant credit risk associated with the securitised exposures is considered as being transferred to third parties, i.e. SRT has been achieved (Articles 244(1)(a) and 245(1)(a) of the CRR); or
 - b) the originator applies a 1 250% risk weight to all retained positions in the securitisation or deducts these securitisation positions from Common Equity Tier 1 (CET1) items, i.e. the full deduction option (Articles 244(1)(b) and 245(1)(b) of the CRR)⁶. In this case, if the transaction is also compliant with the additional requirements specified in Articles 244(4) and 245(4) of the CRR, no regulatory capital on the underlying exposures is therefore required.
22. Where the originator does not opt for the full deduction option, the CRR outlines two possible ways for securitisation transactions to achieve SRT:
- a) compliance with one of two quantitative tests (i.e. mezzanine test and first-loss test) as per Articles 244(2) and 245(2) of the CRR;
 - b) permission from the CA, whereby the originator is allowed to recognise SRT in respect of the securitisation, irrespective of whether or not the transaction meets the quantitative tests as per Articles 244(3) and 245(3) of the CRR.
23. As mentioned above, transferring a ‘significant’ amount of risk is not sufficient. The CRR provides that the possible reduction in the risk-weighted exposure amounts (RWEAs) that the originator holds in respect of the securitised exposures must be justified by a ‘commensurate transfer of credit risk’ to third parties (Article 244(2), second subparagraph; Article 244(3); Article 245(2), second subparagraph; and Article 245(3) of the CRR) as per the CA’s judgement on a case-by-case basis.
24. For a detailed illustration of the CRR framework for SRT, see Annex 1.

2.3.2 EBA Guidelines on SRT

25. The CRR does not fully specify the regulatory or supervisory treatment of a number of issues with direct relevance to SRT, or addresses them in only a partial or indirect manner. The EBA GL on SRT published in July 2014 aim to provide additional guidance for both CAs and originators in terms of their assessments of the SRT, and, hence, to support a more consistent approach to SRT assessments across the EU⁷.

⁶ Irrespective of whether the originator intends to meet condition (a) or (b) as referred to in the previous paragraph, the securitisation transaction it originates must comply with all the requirements specified in Article 244(4) or 245(4) of the CRR, as applicable, including the requirements on an effective transfer of credit risk to third parties.

⁷ The GL deal with matters such as (i) criteria to help CAs to determine when to conduct a comprehensive review of the transaction; (ii) how to assess a number of aspects and structural features of the transaction that are either not treated in Level 1 or covered only partially; (iii) requirements in relation to governance and risk management policies that are

2.4 EBA mandate in relation to SRT

26. Articles 244(6) and 245(6) of the CRR require the EBA to monitor and review the range of supervisory practices in relation to the recognition of SRT in securitisation, and to report to the Commission by 2 January 2021.
27. The specific terms of the mandate on the EBA in relation to SRT are described in Figure 1:

Figure 1: Mandate of the EBA with respect to SRT in the CRR

Traditional securitisation (Article 244(6) of the CRR):

The EBA shall monitor the range of supervisory practices in relation to the recognition of SRT in traditional securitisations in accordance with this article. In particular, the EBA shall review:

- a) the conditions for the transfer of significant credit risk to third parties in accordance with paragraphs 2, 3 and 4;
- b) the interpretation of ‘commensurate transfer of credit risk to third parties’ for the purposes of the CAs’ assessment provided for in the second subparagraph of paragraph 2 and in paragraph 3;
- c) the requirements for the CAs’ assessment of securitisation transactions in relation to which the originator seeks recognition of significant credit risk transfer to third parties in accordance with paragraphs 2 or 3.

The EBA shall report its findings to the Commission by 2 January 2021.

Synthetic securitisation (Article 245(6) of the CRR):

Same language as for traditional securitisation.

28. These articles provide that the Commission may, having taken into account the report from the EBA, adopt a delegated act to supplement the CRR ‘by further specifying the items listed in points (a), (b) and (c) of this paragraph’, while also in accordance with Articles 244(6) and 245(6) of the CRR.
29. The EBA mandate, therefore, should be viewed as a stepping stone towards a potential Commission delegated act that would harmonise the interpretation of those provisions and, thus, the substantive aspects and the process of the supervisory SRT assessment.

considered necessary for the recognition of SRT; (iv) a standard template for CAs to provide information to the EBA, on an annual basis, about all the transactions claiming SRT that have been subject to comprehensive review.

2.5 EBA Discussion Paper on SRT

30. While developed in response to the mandate laid down in Articles 243(6) and 244(6) of the version of the CRR applicable before 1 January 2019, the EBA had already conducted a thorough assessment of supervisory SRT assessment practices in its SRT DP of September 2017⁸. The publication of this SRT DP was followed by a public hearing on 17 November 2017 and written comments were received from a wide range of EU stakeholders.
31. The thorough analysis conducted on that occasion showed divergent supervisory SRT assessment practices across Member States as regards several key subject matters. In particular, the SRT DP singled out these three areas:
 - a) structural features of securitisation transactions: these refer to the treatment for SRT purposes of certain characteristics of both traditional and synthetic transactions that may be detrimental to complying with SRT requirements on a continuous basis and, thus, affect the 'effectiveness' of the risk transfer;
 - b) the SRT tests: these relate both to the interpretation of the quantitative thresholds and measures used by the first-loss and mezzanine tests and to the qualitative commensurateness test in general, for which the CRR provides only high-level criteria; and
 - c) the process applied by supervisors to assess SRT.
32. The SRT DP also found that divergent assessments and outcomes in relation to SRT partly reflect limitations and lack of detailed regulatory requirements in the CRR, including in particular as regards the SRT tests.
33. Overall, the SRT DP concluded that transactions with comparable characteristics may currently be subject to different assessments across Member States because of these divergent supervisory practices, leading to potentially unjustified inconsistencies in SRT outcomes and RWEA calculations.
34. Lastly, the SRT DP put forward preliminary high-level recommendations to strengthen the regulatory and supervisory framework of SRT and to improve regulatory certainty and a level playing field for institutions transferring risk through securitisation.

- ⁸ EBA Discussion Paper on the Significant Risk Transfer in Securitisation, September 2017; see [Link](#)

2.6 Contents of this report: recommendations on SRT assessment

35. This report has been prepared in accordance with the mandate laid down in Articles 244(6) and 245(6) of the CRR. Taking into account the findings of the SRT DP⁹ and building on the high-level recommendations laid out therein, the report specifies a set of detailed recommendations to the Commission on the harmonisation of SRT assessment practices and processes.
36. The report focuses on the three key subject areas singled out by the SRT DP where inconsistencies were found and in relation to which greater harmonisation of both supervisory and market practices and processes would markedly contribute to enhancing the efficiency and consistency of supervisory SRT assessments within the current securitisation framework. The Commission may choose to implement the bulk of the recommendations through the delegated act referred to in Articles 244(6) and 245(6) of the CRR. In a few instances, however, there are matters of a very detailed and technical nature that would be more appropriately laid out in other legal instruments such as EBA GL.

Structural features (Chapter 3)

37. While Articles 244(4) and 245(4) of the CRR contain some provisions on the structural features of securitisations for SRT assessment purposes, those provisions are not exhaustive. They leave significant gaps as regards how originators and CAs should assess the structural features in the context of SRT, and no legal basis is provided on how to deal with certain other features not expressly referred to in the CRR.
38. To provide a level playing field for CAs to assess SRT and to improve the transparency and the predictability of such a supervisory SRT assessment, Chapter 3 identifies specific conditions (safeguards) that a transaction characterised by one or several of the structural features singled out therein should meet to be eligible for SRT recognition without an in-depth structural features review. Chapter 3 also lays down recommendations on the assessment process that the CAs should follow when reviewing the structural features of a securitisation transaction for which SRT is sought.

SRT tests (Chapter 4)

39. The SRT tests have been described in section 2.3.1 above. As mentioned therein, the current regulatory framework uses both quantitative criteria (the mezzanine and first-loss tests) and qualitative criteria (the CRT test) as cumulative benchmarks that CAs must have regard to in order

⁹ This report also takes into account, whenever appropriate, the technical input from stakeholders provided during the public consultation and a roundtable with the industry conducted in July 2020. Whenever relevant, the report also considers various previous EBA pieces of work such as:

- the EBA report on synthetic STS securitisation [Link](#); and
- the Opinion of the EBA to the European Commission on the Regulatory Treatment of Non-Performing Exposure Securitisations [Link](#)

to determine whether the originator has transferred a significant amount of the securitised exposures' credit risk to third parties.

40. Chapter 4 sets out the underlying rationale and the limitations of the SRT tests in the current CRR. To address these and provide for a more harmonised basis for the application of the tests, Chapter 4 recommends (i) supplementing the first-loss test with a requirement that the first-loss tranche has a minimum thickness; and (ii) specifying the CRT test referred to in the CRR with two detailed tests (CRT tests).
41. In addition, Chapter 4 lays down recommendations as regards when to run the SRT and CRT tests, the grandfathering of the SRT granted to existing transactions and the specific treatment of non-performing exposure (NPE) securitisations.

Assessment process and standard documentation (Chapter 5)

42. As noted in the SRT DP, the absence of process requirements in the CRR in relation to SRT leads to divergent supervisory practices and, as a result, increases the risk of inconsistent assessments on identical securitisations.
43. Chapter 5 sets out concrete recommendations for the harmonisation of SRT assessment processes and documentation to address the risk of inconsistent outcomes identified by the SRT DP. These recommendations aim to facilitate and speed up supervisory decision-making on SRT, without compromising the quality and thoroughness of the CAs' assessments or their ability to use their judgement, in particular on transactions that are more complex.

Recommended amendments to the CRR (Chapter 6)

44. The majority of the recommendations laid down in this report are specifically intended for implementation within the current CRR, namely through the Commission's delegated act referred to in Articles 244(6) and 245(6) of the CRR. As the delegated act cannot address all the shortcomings of the current SRT framework described in this report, Chapter 6 recommends various amendments to the CRR that the EBA deems desirable to improve the SRT framework.

3. Structural features

3.1 Introduction

45. While all securitisations follow an identical pattern, there is a significant degree of variation between the structures of individual transactions depending on a number of factors, including the types of securitised exposures, the type of securitisation (synthetic or cash, term or asset-backed commercial paper (ABCP), performing or non-performing underlying exposures), the interests of the parties involved and the agreed contractual terms. While the parties to the securitisation are free to structure their transaction as they see fit, the use of certain structural features may be detrimental to complying with SRT requirements on a continuous basis. For example, in the case of traditional securitisations, the presence of certain of those structural features increases the likelihood that the securitised exposures (or at least the credit risk associated with them) will be brought back onto the originator's balance sheet. In the case of synthetic securitisations, they may increase the risk that the credit protection is not sufficiently effective and/or that it will be terminated before the maturity of the transaction.
46. The EBA's review of SRT market practices and the supervisory approaches to SRT assessments, as illustrated in the SRT DP, identified six structural features that are widely present in securitisation transactions and that may affect the effectiveness and the sustainability of SRT during the maturity of the transaction. These structural features comprise:
- a) the amortisation structure;
 - b) call options;
 - c) other early termination clauses;
 - d) excess spread;
 - e) cost of protection; and
 - f) credit events.
47. The CRR does not fully specify the regulatory or supervisory treatment applicable to these structural features in the context of SRT. The EBA review also found that supervisory approaches to the structural features of SRT transactions are heterogeneous across Member States. The lack of a detailed regulatory framework combined with divergent SRT assessments means that transactions with comparable characteristics may be assessed differently across Member States, leading to potential differences in the SRT assessment and in the calculation of the RWEAs. It also creates uncertainties in the outcome of the SRT assessment performed by CAs within the EU.

48. To strengthen the level playing field in the supervisory assessment and to improve the transparency and the predictability of the SRT assessment by the CAs, it is proposed that:
- a) securitisation transactions that exhibit **ineligible structural features** should not qualify for SRT recognition;
 - b) securitisation transactions that exhibit one or several of the other structural features outlined in this chapter should comply with a set of **safeguards** to have a better chance of qualifying for SRT recognition and to be eligible for the fast-track SRT assessment process; and
 - c) the originator submits in its **risk transfer self-assessment** to the CA a quantitative analysis on how the structural features interact in the context of the transaction and affect the risk transferred to third parties.
49. It is important to note that not all SRT securitisation transactions happening in the market are expected to embed the specific structural safeguards highlighted in this chapter. This chapter highlights a series of features that may be included in a securitisation transaction while potentially affecting its SRT status, and suggests an enhanced framework to be implemented in the presence of those features.
50. The EBA also considers that the use of the full deduction option¹⁰, instead of the SRT tests, does not generally raise prudential concerns provided that the additional requirements pursuant to Articles 244(4) or 245(4) of the CRR are fulfilled. However, part of the recommendations on structural features that follow below should also apply to these transactions (for further details, see Chapter 66 on recommended amendments to the CRR).

3.2 Assessment of and recommendations on structural features

3.2.1 General approach

51. The present chapter includes recommendations on the structural features of SRT transactions aimed at ensuring that SRT is effectively achieved and that it remains operative throughout the lifetime of the transaction. In particular, these recommendations introduce specific conditions that a transaction characterised by one or several of the identified structural features should meet. The implication of not meeting the required conditions should depend on the nature of the structural feature present in the transaction:
- a) **Ineligible structural features:** based on the EBA's review, some structural features appear detrimental to the achievement of SRT. In particular, structural features that are prohibited by the CRR, such as time call options in the case of traditional securitisation (as specified in

¹⁰ I.e. use of CET1 deduction/1 250% risk weights on all retained tranches in a securitisation as per Article 244(1)(b) or 245(1) of the CRR.

Article 244(4)(d) of the CRR), or that are deemed by the supervisory community to be incompatible with the achievement of SRT, such as early termination clauses (other than those allowed in this report), should be considered ineligible structural features. Transactions that include ineligible structural features should be directly disallowed for SRT recognition.

- b) **Other structural features for compliance with which a safeguard is requested:**
- i. Transactions that include certain structural features should meet specific safeguards to ensure the effective transfer of credit risk to third parties and, as a consequence, facilitate the assessment of the transaction by the CA and make the securitisation eligible for the fast-track SRT assessment process. Ultimately, this will also increase the likelihood of SRT being recognised (see Chapter 5 on SRT assessment process).
 - ii. Even if the corresponding transaction documentation does not comprise all the required safeguards in terms of structural features, it could still be eligible for SRT recognition. However, such recognition will be subject to a structural features review made by the CAs on a case-by-case basis and, therefore, these transactions could not qualify for the fast-track assessment process. In particular, the mechanical tests would still apply to these transactions but the CAs will have to assess SRT more thoroughly and conduct a closer examination of the transaction (see Chapter 5 on the SRT assessment process).
- c) **Other complex structural features:** similarly, if a transaction contains a structural feature for which no safeguard has been identified in this report, this should not automatically render the transaction ineligible for SRT but this feature may be assessed by the CA in a structural features review to consider whether it is appropriate to recognise SRT for the transaction.

Recommendation 1: General approach for the assessment of structural features

- a) Where a transaction contains a structural feature that is prohibited by the CRR or deemed incompatible with the achievement of SRT, the transaction should be ineligible for SRT. Ineligible structural features include:
 - i. call options other than those specified in this report;
 - ii. early termination clauses other than those specified in this report.
- b) Where a transaction contains at least one of the identified structural features for which compliance with a safeguard is requested and does not meet all the safeguards as suggested in this report, the CA may trigger a structural features review and decide

whether it is appropriate to recognise SRT. Structural features for which a safeguard is required include:

- i. pro rata amortisation;
 - ii. excess spread;
 - iii. overly high cost of credit protection as defined in this report; and
 - iv. non-contingent premium payment and upfront premium payment.
- c) Securitisation transactions that (i) are issued in accordance with plain vanilla structures or (ii) that incorporate one or several of the identified structural features but conform to the safeguards outlined in this report should be eligible for the fast-track SRT assessment process as long as the other prerequisites for the fast-track process are met (see Chapter 5 on the SRT assessment process).
- d) Where a transaction contains a structural feature that is not prohibited by the CRR and does not fall within the list of identified structural features outlined in this report, the presence of such a feature should not automatically render the transaction ineligible for SRT, but a CA should conduct a structural features review to consider whether it is appropriate to recognise SRT for the transaction. The CA may also conduct a structural features review if a new variation of a known structural feature raises questions regarding the effectiveness of SRT.

3.2.2 Amortisation structure

52. The amortisation structure of a securitisation transaction is the set of rules determining the order and schedule according to which investors in the securitisation are paid the principal and interest amounts:
- a) In terms of schedule, transactions may amortise immediately from closing or may feature an initial limited revolving period. Specific transaction structures may also use bullet payment schedules, which may in turn take the form of soft (i.e. extendible) or hard (non-extendible) bullets.
 - b) In terms of the priority of payments, securitisation transactions may use a sequential priority scheme, a pro rata priority scheme or a hybrid scheme (pro rata to sequential or sequential to pro rata).
53. In the context of a securitisation for which SRT recognition is sought, pro rata amortisation schemes may raise concerns, especially in the presence of back-loaded losses (i.e. losses that

crystallise towards the end of the maturity of the underlying exposures), when all or a major part of the senior tranches is retained. This is because losses may not be borne by the first-loss/mezzanine tranches only, but also by the mezzanine/senior tranches. Sequential amortisation ensures that the first-loss tranche takes any losses, before those losses are allocated to the mezzanine tranches or the senior tranche. Consequently, if an investor invests in the first-loss tranche, sequential amortisation ensures that the investor takes the maximum amount of loss, ensuring a maximum amount of risk transfer.

54. It is a very common market practice for the originator to sell the first-loss tranche¹¹. Therefore, with regard to the majority of currently structured SRT transactions, sequential amortisation structures appear prudentially more sound than pro rata structures.
55. In the case of a pro rata structure, the presence of contractual triggers to switch from pro rata to sequential amortisation when the quality of the underlying portfolio is likely to deteriorate represents a safeguard against the possibility of impaired risk transfer. However, the observed market practices show that the triggers commonly used in securitisation transactions are usually backward looking, as their definition often refers to either realised losses or defaults. Back-loaded losses may build up even in the absence of already realised losses or default events where, for example, the exposures of highest quality in the portfolio pre-pay and the average credit quality of the portfolio start deteriorating.
56. To account for the possibility of higher credit risk in a more forward-looking manner, before losses or defaults materialise, additional parameters such as a changing average probability of default (PD) and granularity in the portfolio should also be considered. Such metrics should ensure that the credit enhancement is not too quickly amortised as the credit quality of the transaction deteriorates or the dependency on cash flows received from individual obligors increases.
57. In the light of the reviewed market practices and the concerns raised by the use of pro rata amortisation in securitisation transactions when all or a major part of the senior tranche is retained, the conditions under which pro rata amortisation should be acceptable in securitisation transactions to be eligible for the fast-track SRT assessment process and to have a better chance of qualifying for SRT recognition should be specified as outlined in Recommendation 2.

Recommendation 2: Amortisation structure

- a) Pro rata amortisation when all or a major part of the senior tranche is retained should be used only in conjunction with clearly specified contractual triggers determining the switch of the amortisation scheme to a sequential priority.

¹¹ Only very few transactions use a pro rata amortisation structure combined with a first-loss tranche retained by the originator, due to the high cost of capital attached to the first-loss tranche.

- b) For securitisations of performing exposures with pro rata amortisation as referred to under point a), at least one (or several when relevant) of the following backward-looking triggers and at least one (or several when relevant) of the following forwarding-looking triggers should be featured in the SRT transaction.

Backward-looking triggers:

- i. cumulative losses at a point in time higher than a given percentage of the lifetime expected losses (LTELs) at inception;
- ii. cumulative non-matured defaults higher than a given percentage of the sum of the outstanding nominal amount of the tranche by which the risk is transferred and the tranches that are subordinated to it;
- iii. increase in the cumulative amount of defaulted exposures/losses greater than a given percentage of the outstanding amount of the underlying portfolio;
- iv. weighted average credit quality in the portfolio decreasing below a given pre-specified level and/or the concentration of exposures in high credit risk (PD) buckets increasing above a pre-specified level.

Forward-looking triggers:

- i. increase in the weighted average 1-year PD of the underlying portfolio (as determined in accordance with internal ratings based (IRB) requirements) greater than a given percentage;
 - ii. increase in the 1-year expected losses (ELs) of the underlying portfolio (as determined in accordance with IRB requirements) greater than a given percentage;
 - iii. increase in the cumulative amount of underlying exposures for which the credit risk has increased significantly since initial recognition (for example international financial reporting standards (IFRS) 9 stage 2) greater than a given percentage of the outstanding amount of the underlying portfolio;
 - iv. granularity of the portfolio falling below a given pre-specified level.
- c) Securitisation transactions for which SRT is sought should include the triggers that are the most relevant to the specific transaction. Additional triggers relevant to the specific transaction could also be added as long as both backward- and forward-looking triggers, as referred to under point b), are featured.
- d) To ensure maximum clarity and provide guidance to originators and CAs for SRT assessment process purposes, the Commission may consider requesting that the EBA develop GL on the applicable triggers and levels that they should be calibrated at. Until such GL are published, CAs should determine the required level of the triggers for transactions with pro rata amortisation to be eligible for the fast-track process.

- e) The amortisation profile should be taken into account within the risk transfer self-assessment submitted to the CA to support the SRT application (see the originator's quantitative self-assessment of risk transfer below).

58. NPE securitisations should not qualify for the fast-track assessment (see paragraph 180). However, NPE securitisations with pro rata amortisation, where all or a major part of the senior tranche is retained and for which SRT is sought, should at least feature a provision whereby the cumulative cash flow amount generated by the underlying portfolio decreasing below [a given percentage] of the total expected cumulative cash flow amount for that period would trigger a switch from pro rata to sequential amortisation.

3.2.3 Call options

59. The call options referred to in this section allow the originator to close the securitisation where material changes to the transaction's characteristics have reduced or eliminated the economic benefit expected from the transaction at the origination date. In this respect, such call options are structural features used to tackle the economic efficiency of the transaction and differ from 'other early termination clauses', which normally relate to either the originator's or the investor's bankruptcy or breaches of legal and/or contractual provisions (see section 3.2.4 on 'other early termination clauses').
60. In traditional securitisations, the originator can call the transaction by repurchasing the securitisation positions before all the underlying exposures have been repaid, provided such repurchase is exceptional and made at arm's length. In synthetic securitisations with embedded call options, the originator may terminate the credit protection agreement ahead of its scheduled maturity.
61. The presence of certain originator's call options in securitisation transactions may prevent an effective risk transfer from the originator to third parties; for instance:
- a) Originator's call options that provide additional credit enhancement in favour of the investor and to avoid allocating losses that the investor should be absorbing. Particularly in bad times, originators may be incentivised to exercise the call options to support investors and/or maintain a positive business relationship. During the last financial crisis, several originators exercised call options as the performance of the securitised portfolio deteriorated, effectively taking back on their balance sheet the risk that they were deemed to have transferred.
 - b) Call options driven by the pricing efficiency of the transactions (i.e. the potential for more attractively priced alternatives in the market) rather than by the SRT transaction efficiency (i.e. remaining cost of the credit protection compared with the ELs).

62. Against this background, it is appropriate to limit the possibility of exercising call options in SRT transactions as follows:
- a) Time calls that are prohibited by the CRR for traditional securitisations should be allowed in synthetic transactions only after a period corresponding to the initial weighted average life (WAL) of a transaction has elapsed to guarantee the effectiveness and the efficiency of SRT during the lifetime of the transaction.
 - b) With regard to SRT calls¹², it is also important to ensure that the applicable rules are sufficiently prudent to avoid moral hazard and regulatory arbitrage behaviour. In particular, a call after an initial SRT assessment due to a refusal of SRT might be appropriate given that it has a direct impact on the purpose and economic viability of the transaction from the very beginning of a transaction. In addition, as the SRT would not yet have been recognised, there is no prudential concern linked with the appropriateness of capital charges. However, an SRT call during the lifetime of the transaction due to SRT being unwound might be problematic, as it might be used to circumvent the general restriction on time calls for traditional securitisations, as well as the restrictions on time calls for synthetic securitisations.
63. In the light of the reviewed market practices and the concerns raised by the use of call options, the conditions under which call options should be acceptable in securitisation transactions to be eligible for the fast-track SRT assessment and to qualify for SRT recognition should be specified as follows:

Recommendation 3: Call options

Only the call options listed and meeting the requirements laid down below should not be considered as hindering the achievement of SRT:

- a) Clean-up calls in both traditional and synthetic transactions that meet the requirements of Articles 244(4)(g) or 245(4)(f) of the CRR.
- b) Regulatory calls in both traditional and synthetic transactions that:
 - i. are linked to changes in all relevant law and/or regulation (or official interpretation of that law and/or regulation by authorities) directly affecting the contractual relationship defining the transaction and/or affecting the allocation of benefits among the parties of the transaction. In this regard, relevant law/regulation includes relevant taxation and accounting provisions and excludes other factors affecting the economic efficiency of the transaction that are not enshrined in law or regulation, such as credit rating agencies' methodologies or central institutions' collateral frameworks;

¹² These allow the originator to terminate the transaction if SRT is not, or is no longer, recognised.

- ii. are triggered by changes in applicable regulation post issuance or changes in the interpretation of applicable regulation post issuance by the CA that have a material adverse effect on the economic efficiency of a transaction.
- c) Time calls in synthetic securitisations that are:
- i. exercisable after a time period measured from the closing date of a transaction corresponding to the initial WAL of a transaction or that are exercisable after a time period measured from the end of the replenishment period of a transaction corresponding to the WAL at the end of that replenishment period. The WAL should be calculated according to the methodology specified in the EBA GL on weighted average maturity (WAM) for the asset model; and
 - ii. included within the risk transfer self-assessment analysis submitted to the CA to support the SRT application (see proposal on the originator's quantitative self-assessment of risk transfer below).
- d) SRT calls in both traditional and synthetic transactions linked to the outcome of the initial supervisory SRT assessment where the CA notifies the originator that it objects to recognising SRT to the transaction.

3.2.4 Other early termination clauses (synthetic securitisation only)

64. Beyond the early termination clauses linked to the cost efficiency of the transaction, other early termination clauses serve the purpose of terminating the transaction whenever specific events occur in relation to one of the parties in the transaction. In particular, the following events may be used to trigger early termination:

- a) failure to pay;
- b) breach of a material contractual obligation;
- c) illegality arising from a contractual obligation;
- d) breach of representations (regarding the capacity of the parties to enter into the credit protection arrangement or regarding the misleading nature of the information/data supplied);
- e) originator's (or protection provider's) bankruptcy (examinership, insolvency, moratorium or similar proceedings);
- f) materially adverse changes to the originator's credit and servicing policies.

65. The use of early termination clauses is very common and constitutes an essential part of the protection of both parties to the contract. However, in the case of synthetic transactions, early termination events generally pose concerns in relation to SRT, as they increase the risk that the credit protection terminates before the maturity of the transaction.
66. In particular, from an originator's perspective, in the case of termination of the contract upon the bankruptcy of the originator, the insolvent originator would no longer be able to rely on the credit protection while it faces reduced regulatory capital resources due to the previous achievement of SRT. In this respect, the question arises whether the achievement of SRT and the resulting capital relief can be deemed adequate from a prudential perspective for transactions including such an early termination event.
67. Similarly, early termination clauses linked to a breach of representation standards or caused by changes in the originator's credit and servicing policies may significantly undermine the sustainability of SRT while no material contractual obligations are breached.
68. Against this background, it is necessary to ensure that the use of early termination events is solely intended to incentivise and to ensure that both parties to the contract comply with their material contractual obligations under the credit protection agreement.
69. In the light of the reviewed market practices and the concerns raised by the use of early termination clauses in the context of synthetic securitisations, the conditions under which early termination clauses should be acceptable in securitisation transactions to be eligible for the fast-track SRT assessment and to qualify for SRT recognition should be specified as outlined in Recommendation 4.

Recommendation 4: Other early termination clauses

- a) Only the following early termination events exercised by the *originator* would not be considered as hindering the achievement of SRT:
 - i. an illegality event;
 - ii. a failure to pay, insolvency or other material breach of contractual obligations by any of the protection sellers; or
 - iii. a collateral default in the case of funded credit protection;
- b) Only the following early termination events exercised by the *investor* would not be considered as hindering the achievement of SRT:
 - i. an illegality event;

- ii. a failure to pay or other material breach of contractual obligations by the originator;
- iii. the insolvency of the originator where that results in a material breach of servicing obligations according to the transaction documentation and no back-up servicer is appointed to take over the servicing of the securitised exposures.

3.2.5 Excess spread

70. In the case of traditional securitisation, Article 1(b) of the final draft regulatory technical standards (RTS) on risk retention in accordance with Article 6(7) of Regulation (EU) 2017/2402 defines excess spread as the difference between the income collected on the securitised portfolio and the costs and other expenses related to the transaction. In the case of synthetic securitisation, excess spread is the amount occurring in the transaction that is contractually designated by the originator to cover losses of the referenced portfolio that might occur during the lifetime of the transaction.
71. The SRT DP made a detailed analysis of market practices regarding the use of excess spread and highlighted the following:
- a) In traditional securitisation, the excess spread normally contributes to all interest and principal payments owed by the transaction in accordance with the contractual priority of payments. Remaining excess spread may be returned to the originator or to the investors in the first-loss tranche.
 - b) In synthetic securitisations, the excess spread may be used as the most subordinated form of credit enhancement according to different practices concerning both its definition (i.e. fixed or variable) and allocation mechanism (i.e. 'the use-it-or-lose-it (UIOLI) mechanism' or 'trap' mechanism').
 - c) Beyond these general practices, the allocation of excess spread may also follow various specific variants such as the 'turboing technique'¹³ or the 'Class X notes'¹⁴ in commercial mortgage-backed security (CMBS) transactions.
72. The SRT DP identified several cases where the presence of excess spread may significantly undermine SRT:

¹³ Both traditional and synthetic securitisations can be structured to include a first-loss tranche sold to investors that can amortise before more senior notes – in the absence of enforcement events – by using excess spread that is not required to cover losses in any given period.

¹⁴ Traditional securitisations can also be structured to achieve the ongoing extraction of excess spread to the benefit of the originator via a specific class of notes that is retained by the originator and whose interest payments are paid *pari passu* to the most senior tranche's interest payments.

- a) In traditional securitisation, the use of excess spread causes concern in relation to SRT where
 - (i) the originator enters into agreements whereby excess spread is in any form or shape a guaranteed amount to the investors or
 - (ii) the pricing of the relevant tranches is not realistic and the excess spread is thereby artificially inflated.

- b) In synthetic securitisations, the main concerns relate to:
 - i. the quantum of synthetic excess spread (SES; i.e. too high an amount of excess spread subordinated to the protection provider's position may be such that under no realistic scenario will the protection provider's securitisation positions be eroded by losses, resulting in no effective risk transfer); and
 - ii. the calculation of variable SES (i.e. the definition of relevant cash flows, in particular of expense/cost items, may be very complex). The discretion and complexity embedded in the specification of excess spread may result in materially different outcomes regarding the actual risk being transferred to third-party investors.

73. In the light of the reviewed market practices and the concerns in relation to excess spread, the conditions under which the presence of excess spread should be acceptable in securitisation transactions to be eligible for the fast-track SRT assessment process and to have a better chance of qualifying for SRT recognition should be specified as outlined below:

Recommendation 5: Excess spread

- a) Whenever excess spread is used in the context of a synthetic securitisation providing first-loss credit enhancement, the originator should commit to a fixed nominal amount of excess spread available in the transaction on a yearly basis to absorb losses on a first-loss basis.

- b) Where excess spread is used in a traditional securitisation transaction as a deferred interest of the originator providing first-loss credit enhancement to the transaction, the transaction should not commit more than the actual excess spread generated by the portfolio, i.e. the originator should not guarantee a fixed (i.e. pre-determined) level of excess spread.

- c) In any case, the transaction documentation should provide a definition of excess spread, including, where applicable, the breakdown composition of 'costs' and 'expenses' mentioned in Article 1(b) of the final draft RTS on risk retention in accordance with Article 6(7) of Regulation (EU) 2017/2402 and the formulae used to compute the excess spread, or the amount that, according to the documentation of a synthetic securitisation, is contractually designated by the originator to cover losses of the securitised exposures that might occur during the maturity of the transaction.

- d) The way in which the excess spread enters the waterfall should be clearly represented.

- e) Excess spread should be taken into account within the risk transfer self-assessment analysis submitted to the CA to support the SRT application (see proposal on the originator's quantitative self-assessment of risk transfer below).

74. Without prejudice to the above, it is not necessary to specify requirements relating to (i) a maximum acceptable threshold for the excess spread and/or (ii) the allocation mechanism because the excess spread should have to be modelled in the mechanical tests to determine whether SRT is achieved.

3.2.6 Cost of protection (synthetic securitisation only)

75. As laid out in the SRT DP, market practice on protection premium payments varies as to how they are formulated and scheduled; for instance:

- a) Protection premiums can be either contingent premiums (i.e. the actual amount of premium paid is a function of the size and the risk of the protected tranche) or non-contingent premiums (i.e. the actual amount of premium paid is not a function of the outstanding size and risk of the protected tranche).
- b) In most cases, protection payments are paid according to a regular schedule but they can also be paid upfront or structured to include protection premium rebate mechanisms.

76. The cost of credit protection may raise significant concerns with regard to the effectiveness of SRT if:

- a) the premium is non-contingent or guaranteed, as such structures may be used to ensure that the premiums paid equal the amount of realised losses, thus eliminating the risk to which investors are exposed;
- b) the costs of protection are calibrated in such a way that the total premiums paid to investors significantly exceed the amount of LTEs under an adverse scenario;
- c) the timing of the profits and losses (P&L) recognition of the costs of protection may enable the originator to postpone the P&L recognition of the credit protection while achieving an immediate capital relief resulting from the SRT recognition.

77. Against this background, it is essential to ensure that the cost of protection is appropriately priced and structured to make sure that the actual risk attached to the underlying exposures is properly captured and transferred to the investor.

78. In the light of the reviewed market practices and the concerns in relation to the cost of protection in synthetic transactions, the conditions that the cost of credit protection should meet in securitisation transactions to be eligible for the fast-track SRT assessment process and to have a

better chance to qualify for SRT recognition should be specified as outlined in Recommendation 6.

Recommendation 6: Cost of credit protection

- a) Synthetic securitisations characterised by an overly high cost of credit protection should be subject to a structural features review. To determine whether a transaction is characterised by an overly high cost of credit protection, at least one of the following conditions should be considered:
- i. The amount of payouts received by the originator is lower than the amount of premiums paid by the originator in an adverse scenario. Such a calculation should be included in the originator's self-risk assessment.
 - ii. The cost of capital relief of the transaction¹⁵ is higher than the total cost of capital of the originator in relative terms. The originator should include this comparison, including the basis of estimation for its total cost of capital, in its risk self-assessment.
 - iii. The remaining portfolio income after protection is not aligned with the new risk profile of the portfolio¹⁶, i.e. the net portfolio income minus the premium paid net of payouts should be at least equal to or higher than the net income of an investment with a comparable risk profile.
- b) Credit protection premiums should be structured as contingent on the outstanding amount of the protected tranche: no form of guaranteed premiums, rebate mechanisms or other mechanisms that may avoid allocating losses to the investor should be featured in the SRT transaction. In particular, the premium should not increase if the level of the credit risk of the underlying portfolio increases.
- c) Upfront premium payments should not be considered as hindering SRT where they are:
- i. fully paid by a third party such as the borrower;
 - ii. fully recognised in the P&L at the payment date; or
 - iii. paid in the context of guarantee schemes specifically provided for in the national law of a Member State and benefiting from a counter-guarantee of any of the entities listed in Article 214(2)(a)-(d) of Regulation (EU) No 575/2013.

¹⁵ Defined as: [annual guarantee fees paid to investors – expected losses allocated to investors in CF model] / capital relief.

¹⁶ It is expected that, because of the cost of protection, the remaining income of the portfolio would be reduced to a level equivalent to other investments with an equivalent risk profile (e.g. other exposures that would receive the same or similar risk weight than the weighted average risk weight of the securitisation positions retained by the originator). A significant misalignment may indicate the presence of an overly high cost of protection. The originator should include this comparison, including the basis of the estimation of the equivalent risk profile, in its self-assessment of risk transfer.

- d) Credit protection premiums should be taken into account within the risk transfer self-assessment analysis submitted to the CA to support the SRT application.

3.2.7 Credit events (synthetic securitisation only)

79. As laid out in the EBA Report on Synthetic Securitisation and the EBA Report on simple, transparent and standardised (STS) synthetic securitisations, credit events are those events that trigger payments of the credit protection from the protection seller to the protection buyer. Typical credit events include:
- a) failure to pay after 90 days (i.e. 90 days past due);
 - b) restructuring of the reference credit/obligor; and
 - c) bankruptcy of the reference obligor.
80. The definition of credit events applied in synthetic securitisation is essential, as it affects the likelihood of credit protection payments occurring and, consequently, determines the extent of protection for the originator and of risk transfer towards investors.
81. The definitions of credit events provided in the CRR shape the way prudential regulation quantifies the credit risk to be covered by regulatory capital. These definitions should also be applied as a basis for defining the minimum credit events to be considered for SRT recognition purposes.
82. Article 245(4)(b) in connection with Article 249(1) of the CRR requires that unfunded credit protection used for the purpose of synthetic securitisation complies with the requirements of Part Three, Title II, Chapter 4 of the CRR. In particular, this means that the credit protection must satisfy the requirements set out in Article 215 (for guarantees) or Article 216 (for credit derivatives) of the CRR. Both Articles 215 and 216 specify what credit events need to apply to trigger a credit protection payment.
83. The parties under the credit protection agreement may agree on additional events or stricter definitions of the events, as long as the credit protection agreement complies at a minimum with the requirements provided in Article 249 of the CRR. All the applicable credit events and their precise definitions should be clearly documented.
84. As the definition of minimum credit events to be included in credit protection agreements is already provided in the CRR, no recommendations have been included in the report in this regard.

3.3 Originator's quantitative self-assessment of risk transfer

85. The previous sections of this chapter include recommendations on the SRT requirements that should facilitate the SRT assessment of structural features and that should also increase the likelihood of a positive outcome of the SRT assessment performed by the CAs.
86. However, the role played by each of the identified structural features, and their interaction in the context of the transaction, may vary on a case-by-case basis. To further support the request for SRT recognition, it is necessary that the originator submits a quantitative self-assessment of risk transfer, aimed at (i) proving to the CA an in-depth understanding of how the structural features interact in the context of the transaction, under well-specified plausible scenarios, and (ii) providing a quantitative representation of the risk transferred to third-party investors over the maturity of the transaction.
87. The complexity of this self-assessment, in terms of scenarios and methodology, should be proportionate to the complexity of the transaction, given that the transaction may embed one or several structural features. It is, however, expected that a cash flow model following the specifications of the assets and liabilities models recommended in Chapter 4 for the SRT tests, and base-case and adverse scenarios, are used to measure the lifetime risk transfer achieved by the transaction and the fulfilment of the SRT tests.

Recommendation 7: Quantitative self-assessment of the risk transfer

- a) The originator should submit to the CA a risk transfer self-assessment, following the specifications of the assets and liabilities models recommended in Chapter 4 for the SRT tests, to accompany its SRT preliminary notice (see Chapter 5 on SRT assessment process) to measure the lifetime risk transfer achieved by the transaction and the fulfilment of the SRT tests, in all cases.
- b) This assessment should also provide evidence as to how total losses absorbed by third-party investors as a percentage of total losses in the transaction and the portfolio over the lifetime of the transaction compare with:
 - i. the average reduction of RWEAs envisaged by the originator post securitisation;
 - ii. the total losses expected to arise over the lifetime of the transaction.
- c) The quantitative assessment should, as applicable depending on the structural features embedded in the transaction, include at least the following elements:
 - i. A base-case and an adverse scenario of losses attached to the underlying exposures, whereby the base-case scenario represents that only ELs take place, and the adverse

scenario that 100% of the UL of the portfolio takes place on top throughout the life of the transaction.

- ii. A base-case and an adverse scenario regarding the timing of the realisation of the losses, whereby the adverse scenario should represent a back-loaded distribution of portfolio losses following the recommendation on distribution on losses in Chapter 4. When combined with an adverse scenario of losses, the scenarios should take into account the [100%] UL as well.
 - iii. The applicable amortisation structure, including the sequential amortisation triggers if the amortisation structure is different from the sequential one.
 - iv. A base-case and an adverse scenario regarding the availability of excess spread, if excess spread is used in the transaction as credit enhancement.
 - v. The stream of credit protection premiums and credit protection payments (if the transaction is of the synthetic type) in a base-case and an adverse scenario.
 - vi. Any time call (admissible only for synthetic transactions).
- d) The quantitative assessment should be carried out on the basis of the transaction's cash-flow model.
- e) In any case, in the context of this exercise, the originator should provide the CA with the cash-flow model used for the quantitative self-assessment of risk transfer.

4. SRT tests

4.1 Assessment of and recommendations on quantitative SRT tests for securitisations of performing exposures

4.1.1 Assessment of the quantitative SRT tests

88. The CRR provides for two possible ways for securitisation transactions to achieve SRT to third parties:
- a) compliance with one of two available quantitative tests;
 - b) permission from the CA to consider that SRT is achieved, irrespective of whether or not the transaction meets the quantitative tests.
89. The quantitative tests use a quantitative formula to assess whether a significant part of the credit risk associated with the securitised exposures is transferred to third parties. The CRR provides for two quantitative tests:
- a) a mezzanine test applicable to transactions with mezzanine securitisation positions (Articles 244(2)(a) and 245(2)(a) of the CRR), which requires the originator to transfer to third parties at least 50% of the RWEAs resulting from mezzanine positions¹⁷;
 - b) a first-loss test applicable to transactions with no mezzanine positions (Articles 244(2)(b) and 245(2)(b) of the CRR), which prescribes that the originator can retain a maximum of 20% of the exposure value of the first-loss tranche, i.e. it requires that at least 80% of the exposure value of such a position is transferred to third parties. It also requires the respective tranche to be sufficiently thick to exceed a reasoned estimate of the EL on the securitised exposures by a 'substantial margin'.
90. The quantitative tests set a benchmark to assess the significance of risk transfer. Passing the quantitative tests, however, is not a sufficient condition to achieve SRT. The CRR gives CAs discretion to decide on a case-by-case basis that the RWEA reduction may not be applied, when the CA considers that the capital reduction is not justified by a commensurate transfer of credit risk to third parties (Article 244(2), second subparagraph and Article 245(2), second subparagraph, of the CRR).

¹⁷ Mezzanine position means a position in the securitisation that is subordinated to the senior securitisation position and more senior than the first-loss tranche and is subject to a risk weight < 1250% and > 25% in accordance with Article 242(18) of the CRR.

Underlying rationale of the quantitative SRT tests

Focus on measuring the significance of the risk transferred

91. In general, the quantitative SRT tests laid out in the CRR focus on measuring the ‘significance’ of the amount of risk transferred to third parties. They do so by comparing the post-securitisation own funds requirements of the originator (i.e. the own funds requirements for securitisation positions retained by the originator) and the own funds requirements for securitisation positions held by third parties on the relevant tranches.
92. In addition to these quantitative SRT tests, the CRR also lays out the concept of ‘commensurateness’ of the risk transferred. This commensurateness refers to the reduction in RWEAs (for the transactions subject to SRT requirements in accordance with Articles 244(2) or 245(2) of the CRR) or the reduction of own funds requirements (for the transactions subject to SRT requirements in accordance with Articles 244(3) or 245(3) of the CRR) achieved as a result of the securitisation. Such a concept involves, in other words, a comparison of the RWEAs or own funds requirements of the originator pre and post securitisation.
93. The concept of commensurateness of risk transferred neither hardwires any tests in the CRR nor is defined by means of any objective benchmark threshold. It is, however, a criterion that CAs may have regard to in order to prevent securitisation transactions from achieving SRT on a case-by-case basis, following an assessment of the transaction. Given the lack of a standardised threshold, practices differ between both CAs and institutions on how to test the commensurateness of risk transfer.

Reflection of underlying EL and UL assumptions of the credit risk framework

94. The tests build on an underlying assumption of the CRR credit risk framework whereby the EL of an exposure is generally covered by any credit risk adjustments (CRAs) applied to that exposure in accordance with the applicable accounting framework, whereas the UL of that exposure is covered by the own funds requirements for credit risk¹⁸. Both of the current quantitative SRT tests apply this general assumption as a basis, although they differ in the manner in which a significant transfer of the UL is measured and in other assumptions underlying the tests.

Underlying assumptions of the mezzanine test

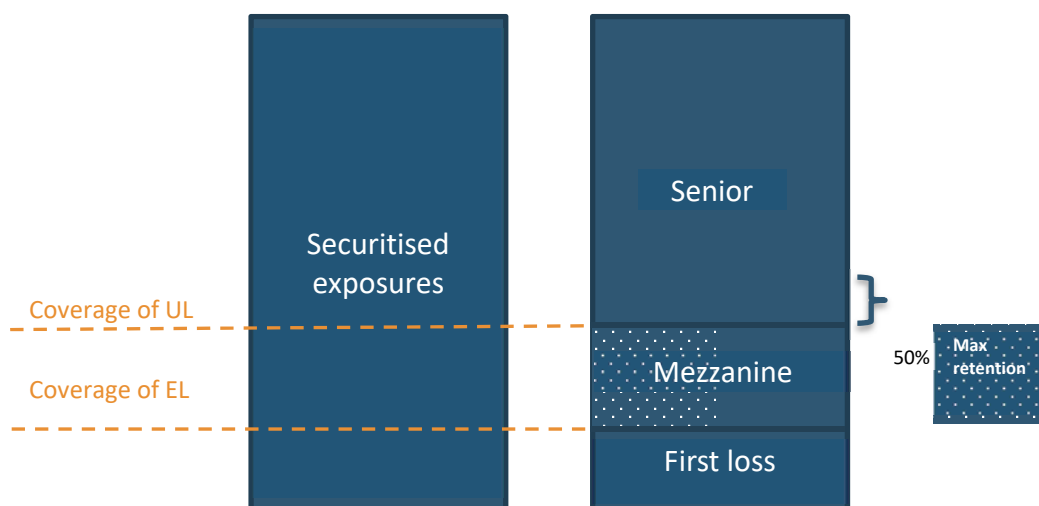
95. The mezzanine test is based on the following assumptions:
 - a) the first-loss tranche of a securitisation with mezzanine securitisation positions covers mainly or exclusively the EL of the securitised exposures;

¹⁸ To cover the UL completely, the own funds requirements for credit risk for a particular exposure must correspond to the current exposure value of such an exposure after a consideration of the SCRAs on the exposure. Instead, the CRR requires institutions to hold own funds against an UL amount that is set by a certain confidence level.

b) the mezzanine securitisation positions cover mainly or exclusively the UL of the securitised exposures.

96. With these assumptions in mind, the mezzanine test is focused on UL and aims for the originator to transfer at least 50% of the UL of the securitised exposures to third parties. For that purpose, when there are several mezzanine tranches, the test effectively weighs the transfer of the UL by the risk weight corresponding to each tranche, weighting the transfer of the UL allocated to the subordinated mezzanine positions more than that of the senior tranches. It is considered irrelevant for the result of the mezzanine test whether the first-loss securitisation positions, which are subject to risk weights close or equal to 1 250% or CET1 deduction, are transferred to third parties or retained by the originator. This is because there should be no significant remaining EL risk left for the originator insofar as the EL residing in the first-loss tranche is either transferred to third parties or retained by the originator and fully covered by specific credit risk adjustments (SCRAs) on the underlying exposures made by the originator and by the remaining capital requirements after deducting any SCRAs and non-refundable purchase price discounts (NRPPDs) connected with the underlying exposures in accordance with Article 248(1)(d) of the CRR.

Figure 2: Rationale of the mezzanine SRT test (test pursuant to Articles 244(2)(a) and 245(2)(a) of the CRR)



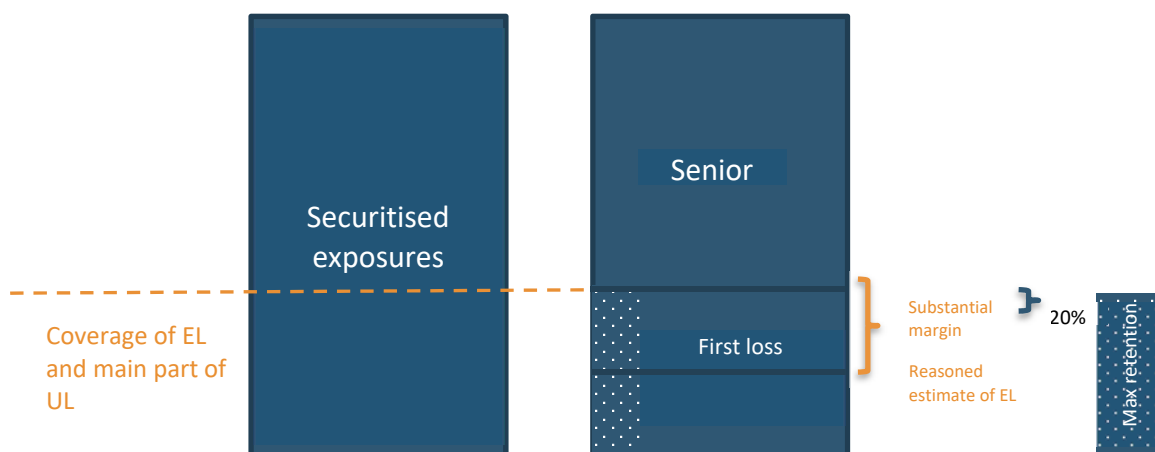
Underlying assumptions of the first-loss test

97. The first-loss test is based on the assumption that, where no mezzanine securitisation positions exist, the thickness of the first-loss securitisation positions is sufficient to cover not only the EL on the underlying exposures, but also a major share of the UL on the underlying exposures. This is reflected in the CRR requirement that the exposure value of such securitisation positions should exceed a reasoned estimate of the EL on the underlying exposures by a substantial

margin. Ultimately, this is grounded on the expectation that the most senior tranche of the securitisation structure is exposed to a minor share of the UL.

98. With this assumption in mind, the first-loss test requires a major share of the first-loss positions to be transferred to third parties, to ensure a transfer of a significant part of the UL, consistent with the spirit of the mezzanine test.
99. While, as explained above, the mezzanine test is indifferent with regard to the retention or transfer to third parties of securitisation positions mainly or exclusively covering the EL, the same does not hold for the first-loss test. Rather, owing to the *pari passu* allocation of the actual losses to holders of the first-loss position (irrespective of whether these losses relate to the EL or UL), the first-loss test may effectively require the originator to transfer parts of the EL as well, depending on the specific structure of the transaction and, in particular, on which portion of the UL is actually covered by the first-loss position.
100. To achieve a comparable extent of transfer of UL to that achieved under the mezzanine test and taking into account that part but not all of the UL may be covered by the first-loss position, the first-loss test imposes a higher threshold for SRT than the mezzanine test (80% v 50%).

Figure 3: Rationale of the first-loss SRT test (test pursuant to Articles 244(2)(b) and 245(2)(b) of the CRR)



Limitations of the current quantitative SRT tests

101. The quantitative SRT tests provide a simple and standardised metric to assess whether a significant share of the UL (in the cases of both the mezzanine and the first-loss test) and also a significant share of the EL (in the case of the first-loss test) have been transferred to third

parties, using post-securitisation own funds requirements on relevant tranches as a measure for the significant transfer of credit risk¹⁹.

102. The SRT DP, the related feedback received from stakeholders and the accumulated experience in the implementation of the recommendations therein revealed a number of limitations to the current quantitative SRT tests. The limitations of the current tests may be fully addressed only in a future amendment of the CRR that would replace the tests with a principle-based approach targeting specifically the transfer of the UL of the securitised portfolio to third parties (see Chapter 4). However, in the short term, the delegated act referred to in Articles 244(6) and 245(6) of the CRR could be used to partly address the weaknesses of the current quantitative SRT tests framework.
103. As a general point, it should be noted that a common disadvantage of using simple and standardised tests is that they are unsuitable to appropriately capture all possible structures of securitisations.

No clear safeguards against the use of relevant tranches with insufficient thickness

104. The CRR tests are grounded on supervisory assumptions as regards the allocation of credit risk losses on the underlying exposures across the securitisation structure, which may not be consistent with the actual allocation of EL and UL in certain transactions. Both first-loss and mezzanine tests implicitly rely on the assumption that the thickness of the tranches subject to the tests is sufficient to cover the corresponding share of EL (first-loss test) and UL (mezzanine test) of the securitised exposures. The tests do not include clear safeguards to ensure that securitisations with relevant tranches that are too thin to cover the corresponding share of EL and UL may not pass the tests, and hence are open to possible regulatory arbitrage.
105. The mezzanine test does not include any such explicit safeguard to ensure a minimum thickness of the relevant tranche. While the first-loss test refers to the thickness of the relevant tranche, such a reference is too vague. The first-loss test requires that the exposure value of the relevant securitisation positions should exceed a 'reasoned estimate' of the EL on the underlying exposures by a 'substantial margin'. However, no further guidance is provided on how a 'reasoned estimate' of the EL should be derived (e.g. whether to consider 1-year EL or EL for the lifetime of the transaction or how to calculate EL for securitisation positions treated under the standardised approach (SA)), and what can be considered a 'substantial margin' in this regard.

¹⁹ The mezzanine test explicitly refers to a maximum share of RWEA held by the originator in respect of mezzanine securitisation positions in this regard. Instead, the first-loss test explicitly makes reference only to a maximum share of the exposure value to be held by originators in the first-loss tranche, which in connection with the RW treatment of first-loss tranches, however, also implicitly results in a use of post-securitisation own funds requirements on relevant tranches as a measure for the significant transfer of credit risk.

No additional requirement to assess the sustainability of the SRT

106. The requirements of the tests have to be fulfilled on an ongoing basis where the originator wishes to exclude the securitised exposures from the calculation of RWEA and use the securitisation framework. The current quantitative SRT tests do not oblige to have regard as part of the initial SRT assessment, whether the requirements would be likely to continue to be met throughout the lifetime of the transaction or any other longer-term period (e.g. a period corresponding to the WAL of the securitised exposures subject to a cap of 5 years). This deficiency in the tests contrasts with the supervisory objective and expectation that SRT must be achieved on a sustainable basis to avoid a substantial volatility of capital ratios caused by SRT transactions.
107. The quantitative SRT tests provide for a point-in-time assessment of the significance of the credit risk transfer to third parties but do not explicitly consider the impact of the expected development of securitised exposures and securitisation positions on the SRT over the maturity of a transaction. From a regulatory perspective, any SRT achieved should be sustainable based on the information available at the closing of the transaction, to avoid the use of SRT transactions for the mere short-term optimisation of capital ratios for individual reporting dates, which would introduce significant volatility in the originator's capital ratios.

Limited focus on the commensurateness of the transferred risk

108. The quantitative SRT tests are generally based on a comparison of the post-securitisation own funds requirements of securitisation positions held by the originators and by third parties on the relevant tranches. By contrast, the assessment of commensurate transfer of credit risk relies on a comparison of the transfer of credit risk to third parties with the possible reduction in RWEAs (Articles 244(2) and 245(2) of the CRR) or the reduction of own funds requirements (Articles 244(3) and 245(3) of the CRR) that an originator would achieve. In other words, the commensurate transfer of credit risk test comprises a comparison of the RWEAs or own funds requirements of the originator pre and post securitisation. However, and unlike for the SRT, the CRR does not include any standardised test for determining the commensurateness of the risk transferred from a quantitative perspective.

Specific limitations of the mezzanine test

109. There are other situations that are not properly covered by the mezzanine test. When the UL of the securitised portfolio is not mainly allocated to the mezzanine tranches, the results of the test could be meaningless. This is the case where the main part, or all, of the UL is not allocated to the mezzanine tranches (e.g. thick first-loss and or senior tranches combined with thin mezzanine tranches; securitisations with excess spread where the main part of the UL is allocated to the first-loss tranche; or NPL securitisations with NRPPD).

Specific limitations of the first-loss test

110. As mentioned above, the CRR does not provide any further guidance on the interpretation of the terms ‘substantial margin exceeding a reasoned estimate of the expected loss’ on which the test is based, neither for securitised exposures under the IRB approach nor for securitised exposures under the SA. While the CRR provides a definition of EL for the purposes of the credit risk framework (Article 5(3) of the CRR), no conditions are provided for what is considered a reasoned estimate of the EL for the purposes of the securitisation framework. It is also not clear what approach should be taken where the securitised exposures are mainly exposures for which the originator cannot calculate the EL (pursuant to the IRB requirements of Article 158 of the CRR). The legal uncertainty resulting from the insufficient specification of these terms is also inconsistent with the underlying objective to provide a simple and standardised test for measuring the significance of the credit risk transfer.

4.1.2 Recommendations on the SRT tests

111. As mentioned above, fully addressing the SRT tests’ weaknesses would require amending the CRR. The recommendations made by the EBA herein as per the mandate laid out in Articles 244(6) and 245(6) of the CRR, however, should address some of the observed shortcomings in the immediate future and could be implemented through the delegated act referred to in those articles.

112. The recommendations are designed to meet the following objectives:

- a) enhancing the consistency of the SRT tests by providing a simple, harmonised and standardised framework that would reduce the scope for differing interpretations by CAs and originators;
- b) as much as possible, fixing and addressing the identified limitations of the tests within the current framework.

113. As regards in particular point (b) of paragraph 112, the recommendations put forward herein should address the limitations of the existing tests by providing the following:

- a) **Standardised requirements for the assessment of commensurateness of the transferred risk.** While undoubtedly any assessment of the commensurateness of the credit risk transfer should not rely solely on quantitative considerations but also on qualitative ones, and while the latter should take into account structural features of the transaction and the securitised exposures, the EBA recommendations provide for an additional harmonised quantitative formula to support the assessment of the commensurateness of a securitisation’s credit risk transfer. Reviewing the interpretation of the commensurateness of risk transfer is explicitly alluded to in the mandate given to the EBA in Articles 244(6) and 245(6) of the CRR.

- b) **Enhanced sustainability of the SRT.** The EBA recommendations include requirements to consider the achievement of SRT in the longer term to reflect the regulatory objective that SRT should be sustainable to avoid increased volatility of capital ratios caused by SRT transactions.
- c) **Safeguards against the use of relevant tranches with insufficient thickness.** These should prevent cases of possible regulatory arbitrage where the requirements of the tests are passed without effective transfer of a significant amount of credit risk.
114. When considering these recommendations, it should be borne in mind that no combination of tests can ensure a similar treatment of all securitisations for SRT assessment purposes, insofar as the current tests target very different securitisations (in terms of both their generic structure and their specific structural features) and certain inconsistencies may remain. It is, however, important to limit such inconsistencies and ensure that the quantitative tests lead to consistent results for the vast majority of securitisations that are expected to meet the safeguards on the structural features described in Chapter 3. All other cases should be addressed on a case-by-case basis at the CA's discretion, which should remain capable of deciding when a significant amount of credit risk has not been transferred to third parties due to a lack of commensurate transfer of credit risk (in accordance with the second subparagraph of Articles 244(2) or 245(2) of the CRR).
115. The EBA recommends the following in connection with the quantitative tests:
- a) to further specify a minimum thickness of the first-loss tranche to supplement the first-loss test; and
 - b) to specify two tests that would help quantify the 'commensurateness' of the risk transfer.

Supplementary requirement on a minimum thickness of the first-loss tranche in the first-loss test

116. As explained above as regards the limitations of the existing SRT tests, the CRR does not further define a minimum thickness that the relevant tranches used to demonstrate the SRT should have as a condition to pass the tests. As per paragraph 3.1(c) of the EBA GL on SRT, a comprehensive assessment should be conducted on a securitisation where there is particular information indicating that the thickness of the tranches used to demonstrate SRT may not be sufficient to deliver a commensurate risk transfer to third parties having regard to the specific credit risk profile and the RWEAs of the securitised exposures underlying the securitisation. A comprehensive assessment is also required according to the EBA GL when the losses incurred on the securitised exposures in previous periods or other information indicate the following:
- a) An institution's reasoned estimate of the EL on the securitised exposures until the maturity of the transaction may be too low to consider significant credit risk as having been

transferred to third parties. The total maturity of the transaction should be taken into account, including the potential existence of excess spread.

- b) The margin by which the securitisation positions that would be subject to CET1 deduction/1 250% risk weights exceed the reasoned estimate of the EL until the maturity of the transaction may be too low to consider significant credit risk as having been transferred to third parties.

117. To ensure that the tranche subject to the first-loss test is sufficiently thick to cover the corresponding shares of EL and UL, the EBA recommends defining a minimum thickness of the first-loss tranche, which would be applicable to securitisation transactions subject to the first-loss test as per the formula outlined in Recommendation 8.

Recommendation 8: Requirement for transactions subject to the first-loss test

Traditional securitisations

Nominal value of first loss tranche

\geq Lifetime EL + $\frac{2}{3}$ of Regulatory UL

– Equivalent Exposure Value of Excess Spread (EEVES) if market test is met

– Lifetime EL and UL covered by NRPPD

Synthetic securitisations

Nominal value of first loss tranche

+ Equivalent Exposure Value of Excess Spread (EEVES) in synthetic securitisations

\geq Lifetime EL + $\frac{2}{3}$ of Regulatory UL

118. For these purposes, the nominal value of the respective first-loss tranche and equivalent exposure value of excess spread (EEVES) (see definition in point (b) of Recommendation 10 in synthetic transactions should at least cover the sum of LTEL and two-thirds of the regulatory UL. EEVES should be considered as a retained position in the case of synthetic transactions, as it is a commitment by the originator to provide credit enhancement to the protection provider and such a commitment encumbers the originator's P&L account. This minimum thickness requirement would ensure that the first-loss tranche, together with EEVES, is sufficiently robust to cover the EL and a major share of the UL, as 80% of the exposure value of the first-loss tranche needs to be transferred to third parties in accordance with Articles 244(2)(b) and 245(2)(b) of the CRR. For the sake of clarity, EEVES in synthetic securitisations is not currently considered in the calculation of attachment and detachment points under Article 256 of the CRR, nor it is subject to capital requirements. In this context, the EBA is suggesting some amendments to the CRR (see Chapter 6).

119. In the case of traditional securitisations, the excess spread is generated within the securitisation special purpose entity (SSPE) and the originator only has a possible upside as a deferred income. Therefore, it is not risk retained, and the risk-absorbing effect of the EEVES should be recognised by reducing LTEL + 2/3 of Regulatory UL as long as the market test described in paragraph 125 is met (see Recommendation 12). In the same vein, the risk-absorbing effect of the NRPPD should be recognised by reducing LTEL + 2/3 of Regulatory UL by such a risk-absorbing effect of the NRPPD. This requirement would ensure that the first-loss tranche is sufficiently robust to cover the remaining EL and a major share of the UL, taking into account that 80% of its exposure value needs to be transferred to third parties. Again, for the sake of clarity, EEVES in traditional securitisations is not considered in the calculation of attachment and detachment points under Article 256 of the CRR nor is it subject to capital requirements.

Method for the calculation of the LTEL and UL

120. By making the calculation of the share of the losses dependent on the assessment of LTEL, and by explicitly requiring that the impact of the expected development of securitised exposures and securitisation positions on the SRT be assessed over the maturity of a transaction, the tests would address the sustainability of the risk transfer throughout the life of the transaction, which is one of the limitations of the current quantitative SRT tests as explained above.

Recommendation 9: Method for the calculation of the LTEL and UL

- a) For the purpose of calculating LTEL, the EBA recommends adopting a model approach, whereby originators would determine the LTEL as the sum of the EL throughout the life of the transaction based on:
 - i. In the case of IRB portfolios, IRB parameters.
 - ii. In the case of SA portfolios, accounting standards (expected credit loss (ECL) provisioning), unless the CA justifiably considers the use of such ECL provision inadequate for a specific case. In such a specific case, the originator should model LTEL based on other internal risk parameters, such as those considered in the internal capital adequacy assessment process (ICAAP) of the originator, demonstrating the prudence of the alternative method, which should be assessed by the CA.
- b) For both IRB and SA portfolios, to determine the cash flows of the securitised exposures and the EL of each period, originators should use the assumptions on the asset model set out in the GL on the methodology to determine the WAM of contractual payments due under the tranche of a securitisation transaction (GL on WAM), published by the EBA in May 2020. However, for the purposes of LTEL, future defaults of the performing portfolio should also be modelled. The principal and interest payments of exposures that would default in the future should be assumed to be zero from the time of the expected date of default. Recoveries from the future defaulted exposures should be modelled in accordance with the requirements on

exposures not performing at the time of the calculation set out in the GL on WAM. Originators should assume that all the recoveries will take place at the final legal maturity of the transaction at the latest.

- c) In relation to the calculation of UL, the regulatory UL should be calculated by reference to the originator's CRR total capital ratio of 8% without taking into consideration the Capital Requirements Directive (CRD) capital buffers. Therefore, the UL of the portfolio would be the result of multiplying the RWEAs of the underlying portfolio by the total capital ratio of 8%, as set out in Article 92 of the CRR. As the regulatory UL is used not only for the purposes of the minimum thickness of the first-loss tranche in the first-loss tranche test but also in the CRT tests, the impact of taking into account the total capital ratio of 8% and the capital buffers for the calculation of the UL in the denominator of the CRT ratios would make the CRT tests much stricter for institutions subject to additional capital buffers.

Allocation of LTEL and UL to tranches

Recommendation 10: Allocation of LTEL and UL to tranches

- a) Originators should model the cash flows of the tranches and the allocation of losses to the tranches based on a cash-flow model, for which they should use the assumptions on the liability model set out in the GL on WAM.
- b) For the purposes of the allocation of LTEL and UL to the tranches, the EEVES should be treated as a tranche. EEVES is the size of an equivalent first-loss tranche that would absorb the same amount of losses throughout the life of the transaction under the relevant scenario, which implies that the EEVES may be different in an evenly loaded loss scenario from a back-loaded loss scenario. Therefore, EEVES does not take into account the part of excess spread that goes back to the originator as a deferred income, but only the part that absorbs EL and UL throughout the life of the transaction in accordance with the model. As the SRT assessment is forward looking, EEVES includes both the UIOLI and trapped excess spread mechanisms, meaning that, when some excess spread is trapped in a period and used in the following periods in accordance with the model, the amount used to cover those losses should be that which is taken into account for the EEVES calculation. Generally speaking, the UIOLI mechanism would lead to a lower EEVES than the trapped mechanism.
- c) Originators should take the amortisation system of the tranches into account in the liability model in accordance with the provisions set out in the GL on WAM. As an exception, triggers that switch the amortisation system on the basis of the performance of the underlying exposures, the level of delinquencies or the accumulated losses, or the outstanding amount of the tranches should be assumed active in a future period changing the amortisation system of the tranches if, according to the asset and the liability models and the considered scenario,

the circumstances that are linked to the respective trigger would happen in that future period or have already happened in previous periods.

- d) LTEL calculated under the asset model should be distributed throughout the life of the transaction in two different scenarios (back-loaded or evenly loaded scenarios) where the transaction features a pro rata amortisation system or triggers that switch the amortisation system and the originator retains the senior tranche. The allocation of LTEL and UL to the tranches should be made in the two different scenarios.
- e) The evenly loaded scenario should be the base-case scenario, which would also be used in the case of sequential amortisation. According to the amortisation profile of the securitised exposures and the risk parameters (same percentages of PD, where applicable, and EL are applied on the outstanding amount of the securitised exposures every period), originators should determine the LTEL using the asset model as the sum of the EL throughout the life of the transaction. The effect of the defaults due to EL in each period is reflected in lower cash flows coming from the asset model, which the liabilities model allocates to the tranches according to the waterfall every period. Within this model, UL should be assumed to occur during the last year of the transaction, after EL has been realised and allocated. UL should be allocated to tranches in a manner consistent with the allocation of EL, by order of subordination from bottom to top. Therefore, the liabilities model will determine which tranches are not fully repaid at the end of the transaction, having taken their part of the LTEL and the UL, and the amount of LTEL and UL that excess spread will absorb (EEVES).
- f) A back-loaded losses scenario should be such that $\frac{2}{3}$ of the absolute amount of defaults that would happen in the evenly loaded scenario would take place in the last $\frac{1}{3}$ part of the life of the transaction. As in the evenly loaded scenario, UL should be fully allocated to the last year of the transaction, after EL has been realised and allocated. Institutions should follow the same procedure as explained in the evenly loaded scenario to calculate LTEL and allocate LTEL and UL to the tranches and EEVES.

Use of models

Recommendation 11: Use of models

Originators should use an asset model and a liability model based on those laid out in the GL on WAM to determine LTEL, EEVES and the allocation of LTEL and UL to the tranches and EEVES. Consequently, these models should be subject to the same requirements on initial review, and periodical review if used repeatedly for different transactions, as the models used for the purpose of the calculation of WAM, and should not require the prior approval of the CA.

Two new tests of commensurateness of the risk transfer

121. It is recommended that two new tests be introduced to harmonise the assessment of commensurateness of the transferred credit risk and, as far as possible, address the limitations of the current quantitative SRT tests, especially the mezzanine test, as highlighted above. These tests complement each other and, accordingly, for the transfer of credit risk to be commensurate, the two tests should be passed. Failing one or both of them would imply that the transfer of risk would not be commensurate with the reduction in RWEAs or the own funds requirement for the purposes of Article 244(2)-(3) and Article 245(2)-(3) of the CRR. In such a case, the CA may decide on a case-by-case basis that significant credit risk shall not be considered transferred to third parties.
122. The two suggested tests should be as follows:
- a) The first is a principle based approach (PBA) test whereby a minimum of 50% of the regulatory UL of the underlying portfolio should be transferred to third parties. The allocation of the UL to the tranches would be done as set out in Recommendation 10.

Recommendation 12: PBA test

PBA test:

$$0.5 \leq \text{Ratio} \frac{\text{Regulatory UL on transferred positions}}{(\text{Regulatory UL of the underlying portfolio})}$$

Ratio:

- (i) Numerator: the regulatory UL on the transferred positions should take into account the allocation of LTEL and regulatory UL to the tranches in accordance with Recommendation 10. Therefore, in those cases in which the transaction features EEVES- or NRPPD-absorbing losses, the allocation of the UL to the tranches takes into account this circumstance.
- (ii) Denominator: the regulatory UL of the underlying portfolio calculated in accordance with point (c) of Recommendation 9 above, minus the part of NRPPD that absorbs UL, minus the part of EEVES that absorbs UL in traditional securitisations if the market test is met. For that purpose (i) selling more than 15% of each of the tranches that are not 1 250% risk-weighted or (ii) demonstrating to the satisfaction of the CA that the pricing of those tranches is consistent with market conditions (e.g. by comparison with the pricing of other tranches of similar characteristics placed by the originator, or with other securitisation tranches in recent public placements) should be a requirement for the recognition of the risk-absorbing effect of EEVES.

- b) The second test should provide for a quantitative measure of the commensurateness of the risk transfer (CRT), whereby the transfer of risk should be regarded as commensurate where the ratio of RWEAs/capital reduction achieved by the originator (measured in Ratio 1) were equal to or lower than the ratio of risk transferred to third parties (measured in Ratio 2). The CRT test would be calculated in accordance with the following formula:

Recommendation 13: CRT test

CRT test:

$$\frac{\text{Ratio 1: } (capital\ presec.) - (capital\ post\ sec.)}{(capital\ presec.)} \leq \frac{\text{Ratio 2: } (Lifetime\ EL + reg.\ UL)\ on\ transfered\ positions}{(Lifetime\ EL + reg.\ UL)\ of\ the\ underlying\ portfolio}$$

Ratio 1:

- (i) the difference between the **own funds requirements pre securitisation** on the whole underlying portfolio calculated according to the general credit risk framework, including the EL shortfall where applicable, and SCRA's on the one hand, and the **own funds requirements post securitisation** calculated in accordance with the securitisation framework corresponding to all credit risk retained by the originator on the other hand, including the SCRA's that remain on balance and the NRPPD; and
- (ii) the own funds requirements pre securitisation on the whole underlying portfolio calculated according to the general credit risk framework, including EL shortfall where applicable, and SCRA's.

Ratio 1 measures the savings in own funds requirements achieved by the originator through a securitisation. For the purposes of calculating those savings, the pre-securitisation own funds requirements on the underlying portfolio should include capital deductions, calculated in accordance with the general credit risk framework, and should take also into account:

- the indirect effect on the capital of the originator of the SCRA's made on the securitised exposures prior to the securitisation and their eventual de-recognition after the securitisation in accordance with the applicable accounting standards; and
- the effect of deductions on capital due to an underprovisioning of the underlying portfolio in accordance with Article 36(1)(d) of the CRR (EL shortfall), in the case of IRB securitised exposures, prior to securitisation.

Furthermore, Ratio 1 has regard to (i) the originator's own funds requirements and deductions post securitisation after the eventual application of the caps in accordance with Articles 267 and 268 of the CRR on the retained positions in the securitisation, calculated in accordance with the securitisation framework, (ii) including the SCRA's that remain on balance sheet where there is no accounting de-recognition and (iii) taking into account the impact on the originator's P&L account of the NRPPD. For the sake of clarity, EEVES in synthetic transactions is not considered in the own funds

requirements on the retained positions, since it is not currently subject to any capital requirement, although it is recommended for a future amendment of the CRR (see Chapter 6).

Ratio 2:

- (i) the LTEL + regulatory UL of the underlying portfolio allocated to securitisation positions transferred to third parties, in accordance with Recommendation 10 above; therefore, in those cases in which the transaction features EEVES- or NRPPD-absorbing losses, the allocation of the LTEL and the regulatory UL to the tranches takes into account this circumstance; and
- (ii) the LTEL + regulatory UL of the whole underlying portfolio – the risk-absorbing effect of SCRA offset from the exposure value (EV) of a retained tranche subject to 1 250% risk weights that remain on balance sheet – NRPPD – EEVES in traditional securitisations if the market test is met.

Ratio 2 measures the risk transferred to third parties throughout the life of the transaction. It sums the amount of the LTEL and regulatory UL allocated to all the positions that have been transferred to third parties and compares that amount with the amount of the LTEL and regulatory UL of the securitised portfolio. In this regard, the risk-absorbing effect on the latter of:

- SCRA kept on balance sheet after securitisation and offset from the exposure value of a 1 250% risk-weighted tranche retained by the originator;
- the part of the NRPPD that absorbs LTEL and UL; and
- EEVES in traditional securitisations if the market test is met, as set out in Recommendation 12,

should be recognised in the denominator of Ratio 2 by reducing the LTEL and UL of the securitised portfolio.

123. By making reference to capital requirements, the CRT test would ensure a consistent interpretation of Articles 244(2)-(3) and 245(2)-(3) of the CRR. This is because, as per the CRT test and for the specific purposes of assessing the commensurateness of risk transfer, the RWEAs should be multiplied by 8% to calculate own funds requirements in accordance with Article 92 of the CRR. As paragraph 3 of those articles refers to own funds requirements instead of RWEAs, which, by contrast, are referred to in paragraph 2, it could be interpreted that the former include the capital buffers set out in Directive 2013/36/EU (CRD). Insofar as the capital buffers set out in the CRD are not directly linked to the risk of the securitised exposures, and to be consistent with the calculation of the regulatory UL suggested in point (c) of Recommendation 9, only the total capital ratio of 8% set out in Article 92 of the CRR should be used for the purposes of the CRT tests. In this manner, the CRT tests would not depend on whether the originator is subject to the aforementioned capital buffers or, for instance, on the

varying countercyclical capital buffer imposed in different jurisdictions and, thus, would make the SRT assessment homogeneous between different jurisdictions and originators.

124. As referred to in paragraph 118, EEVES should be considered a retained position in the case of synthetic transactions. However, the allocation of all or part of the LTEL to it affects the allocation of the remaining LTEL and regulatory UL to the tranches and the transferred positions and, therefore, indirectly intervenes in the calculation of the numerator of Ratio 2.
125. In the case of traditional securitisations, the excess spread is generated within the SSPE and the originator only has a possible upside as a deferred income. Therefore, EEVES in traditional securitisations is neither risk retained nor risk transferred to third parties, and its risk-absorbing effect should be recognised by reducing the amount of the LTEL and regulatory UL of the securitised portfolio in the denominator of Ratio 2. However, to ensure that too low coupons on the retained tranches do not artificially inflate the excess spread, the originator should demonstrate that the relevant tranches of the securitisation have been correctly priced. For that purpose (i) selling more than 15% of each of the tranches that are not 1 250% risk-weighted or (ii) demonstrating to the satisfaction of the CA that the pricing of those tranches is consistent with market conditions (e.g. by comparison with the pricing of other tranches of similar characteristics placed by the originator, or with other securitisation tranches in recent public placements) should be a requirement for the recognition of the risk-absorbing effect of EEVES in the denominator of Ratio 2. However, the allocation of the LTEL and regulatory UL of the underlying portfolio to securitisation positions transferred to third parties, in accordance with Recommendations 10 and 11, takes EEVES in traditional securitisation into account in any case, regardless of whether the market test described above is met.
126. On the other hand and for the purposes of Ratio 2, as mentioned above, LTEL should be used instead of 1-year EL. This reflects a conservative approach to measuring the commensurateness of the risk transfer, aimed at ensuring that the reduction in own funds requirements achieved by the originator reflects the share of losses transferred to third parties for the life of the transaction.
127. In cases where the denominator of the PBA test or of Ratio 2 of the CRT test is zero or negative, meaning that there is no remaining risk to be transferred to third parties, the value of the ratio is indeterminate or not meaningful, and the CA should apply additional scrutiny on such cases, making a case-by-case assessment.
128. Transactions featuring a pro rata amortisation system or triggers that switch the amortisation system and where the originator retains the senior tranche should pass the two tests of commensurateness of the risk transfer under the back-loaded and evenly loaded scenarios. In all other cases, transactions should pass the two tests of commensurateness of the risk transfer under the evenly loaded scenario only.

When to run the SRT and CRT tests

129. By making the calculation of the share of the losses dependent on the assessment of LTEL, and explicitly considering the impact of the expected development of securitised exposures and securitisation positions on the SRT over the maturity of a transaction, the tests address the issue of the sustainability of the risk transfer. Accordingly, both tests should be performed as part of the initial SRT assessment of the transaction, but should not be used for the purpose of ongoing monitoring of SRT.
130. However, and without prejudice to the initial SRT assessment, the SRT assessment for a given securitisation should be re-run where the originator executes any 'transaction' as defined in Article 250 of the CRR and paragraphs 13(b), 17 and 18 of the EBA GL on Implicit Support, and that transaction is not structured to provide support. The meaning of transaction therein is very broad, as the CRR and the GL provide that it includes, but is not limited to, any amendments to the securitisation documentation and changes to the coupons, yields or other features of the securitisation positions. Where, by contrast, the transaction is entered into to provide implicit support to the securitisation transaction, the originator shall include all of the underlying exposures in its calculation of RWEAs, thus ceasing to fulfil SRT, in accordance with Article 250(5) of the CRR.

Recommendation 14: When to run the SRT and CRT tests

- a) It is recommended that the SRT and CR tests be performed as part of the initial SRT assessment of the transaction, but not be used for the purpose of ongoing monitoring of SRT.
- b) In the case of incorrect or incomplete information provided to the CA at the time of the original SRT assessment, the SRT tests should be re-run including the missing information when this situation is noted by the CA. This reassessment should be done taking into account all the information, including that which is incorrect or incomplete, and the situation of the transaction at the time of the original assessment so that the SRT may be confirmed or withdrawn with effect from that time.
- c) Without prejudice to the initial SRT assessment, the SRT assessment for a given securitisation should be re-run where the originator executes any 'transaction' as defined in Article 250 of the CRR and paragraphs 13(b), 17 and 18 of the EBA GL on Implicit Support, and that transaction is not structured to provide support.

Grandfathering of the SRT granted to existing transactions

131. As a general principle of law, a legal act may not have a retroactive application in cases where there is a ‘transaction-based’ application of the law. That is, the law that applies to that transaction is the law that was applicable at the time the transaction was concluded and it would be disproportionate to ‘undo’ this legal certainty given the costs and related burden.

Recommendation 15: Grandfathering of the SRT granted to existing transactions

It is recommended that the Commission expressly provides in the delegated act for the grandfathering of the SRT granted to any transactions before the date of its entry into force. This should be without prejudice to the possibility of the CA reassessing the transfer of risk at any time after the first SRT assessment if the institution provided incorrect or incomplete information at that time.

4.2 Assessment and recommendations on quantitative SRT tests for NPE securitisations

132. The regulatory community has conducted extensive work on NPE securitisations since the end of the financial crisis. The stock of NPEs became then, remains today and will probably remain after the COVID-19 crisis one of the most important hurdles to restoring institutions’ full lending capacity in several Member States, as well as a drag on their profitability that may eventually turn, in certain cases, into a threat to their viability²⁰. This report will not repeat the analysis made since then but will instead focus on the specific aspects linked to the treatment of NPE securitisation in the SRT assessment.

²⁰ The EBA (2016) published a report on NPEs in the European Union, quantifying the extent of the problem and identifying several impediments to the timely and efficient resolution of the NPE problem. The European Commission (2017) launched a consultation on the development of secondary markets for non-performing loans, mandating the EBA to introduce due diligence data and disclosure templates aimed at facilitating the functioning of NPEs’ secondary markets. The Council of the European Union (2017) published an action plan on the resolution of NPEs, backed by a technical report, calling for action and reform in the areas of institution supervision, national insolvency frameworks, a secondary market for NPEs and a restructuring of the banking industry. The ESRB (2017) published a report that provides policymakers with general guidance with respect to the steps that need to be taken to design the overall response to the NPE issue. The EBA SRT DP (2017) made an extensive analysis of the market practice and the core elements of NPE securitisations. In October 2019, the EBA published an opinion on the regulatory treatment of securitisations of NPEs, which has been followed by further work by the Basel Committee on Banking Supervision, who published for consultation in June 2020 a technical amendment on the capital treatment of securitisations of NPLs. The European Commission, as part of the Capital Markets Recovery Package aimed at facilitating bank lending to households and businesses throughout the EU, proposed in July 2020 the removal of existing regulatory obstacles to the securitisation of NPEs, based on extensive work and analysis carried out by the EBA in 2019 and 2020.

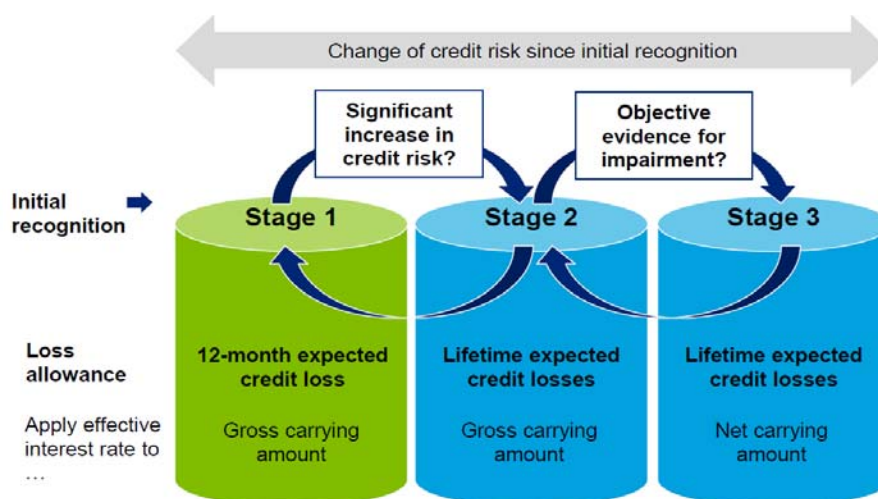
4.2.1 The accounting treatment of NPE securitisations

133. The accounting treatment is of paramount importance for NPE securitisation, as the accounting de-recognition of the securitised NPEs features, together with SRT and regulatory capital relief, as the main objective of the transaction's originator. NPE securitisation serves as a tool for originator institutions to undertake balance-sheet cleaning, which can be achieved only if the securitised exposures are ultimately de-recognised from their accounts.
134. The monitoring of market and supervisory practices in the area of SRT highlighted that, in some cases, securitisation transactions achieve accounting de-recognition but are not granted SRT. In these instances, originator institutions must include the securitised exposures in the calculation of their RWEAs, irrespective of the accounting de-recognition. It is important to note that, in the absence of SRT recognition, the originator's prudential balance sheet reflects at all times the risk arising from the securitised portfolio.

Provisions (credit risk adjustments)

135. With the entry into force of the IFRS 9 (January 2018), the accounting approach under the IFRS 9 accounting model for determining provisions changed from an 'incurred loss model' to an 'expected loss model'. In particular, institutions using IFRS 9 have to take provisions in accordance with a three-step approach, as outlined in Figure 4.

Figure 4: Impairment requirements under IFRS 9



Source: Deloitte

136. The three-stage approach, and, in particular, the requirement to take provisions for LTEs when a significant increase in credit risk occurs and ahead of objective evidence of impairment, aims

to improve the timeliness of provisions and increase the level of provisions taken in the banking system.

137. Regulation (EU) 2019/630 of 17 April 2019, amending the CRR as regards the minimum loss coverage for NPEs, defines the term NPE and complements the existing prudential rules in the CRR relating to own funds with additional rules requiring a deduction from own funds where NPEs are not sufficiently covered by provisions or other adjustments.

4.2.2 Pre- and post-securitisation own funds requirements in NPE securitisation

138. The relationship between the own funds requirements applicable to NPE portfolios (i.e. pre-securitisation capital requirements) and the own funds requirements applicable to NPE securitisation positions (i.e. post-securitisation capital requirements) is crucial in at least the following respects:

- a) for an originator institution, the extent of capital relief that the originator may achieve when disposing of NPEs through a securitisation transaction while, where applicable, retaining certain securitisation positions, determines the economic viability of NPE transfers through the securitisation technique;
- b) for an institution seeking to invest in NPEs, that relationship affects the incentives of institutions to take part in the NPE securitisation investor base compared with other alternative investment options (i.e. whole NPE portfolio acquisitions).

Pre-securitisation own funds requirements (credit risk framework)

Figure 5: Own funds requirements on NPEs

	IRB institution		SA institution
	F-IRB	A-IRB	
RWEA component	Risk weight = 0	Risk weight = $\max\{0, 12.5 \times (\text{LGDD} - \text{EL}_{\text{BE}})\}$	<u>Unsecured component:</u> Risk weight 150%: if SCRAAs < 20% of gross unsecured exposure value; Risk weight 100% if SCRAAs ≥ 20% of gross unsecured exposure value. <u>Secured component:</u> Risk weight 100% on secured EAD after CRAAs.
Own funds component	Limited IRB excess (+)/full IRB shortfall (-) own funds adjustment = (general/specific CRAAs) – LGD ²¹	Limited IRB excess (+)/full IRB shortfall (-) own funds adjustment = (general/specific CRAAs) – EL _{BE}	General provisions may be added to Tier 2 capital up to 1.25% of RWEAs.

A-IRB, advanced internal ratings based; CRA, credit risk adjustment; EAD, exposure at default; EL, expected loss; EL_{BE}, expected loss best estimate for defaulted exposures; F-IRB, foundation internal ratings based; LGD, loss given default; LGDD, loss given default in default.

²¹ For F-IRB institutions, the EL on NPEs corresponds to the supervisory LGD value applicable in accordance with the F-IRB framework, given that PD = 1 for NPE exposures.

139. The own funds requirements on NPEs under the SA framework comprise an RWEA component and an own funds adjustment linked to provisions. Specific provisions taken in accordance with the applicable accounting framework have a twofold role: (i) they reduce the exposure value used as a basis to compute RWEAs and (ii) on the basis of a 20% threshold relative to the gross unsecured exposure value, they determine whether a 100% or 150% risk weight is applicable to unsecured defaulted exposures. The risk weight applicable to the secured part of a defaulted exposure equals 100%. The own funds adjustment component relates to general provisions taken against NPEs, whereby such provisions may, under specific limits, be added back to Tier 2 capital in accordance with Article 62(c) of the CRR. Despite the high risk weights applied to defaulted exposures in the SA framework, high levels of provisions may lead to lower levels of the RWEA component of the requirement (exposure at default reduction effect).
140. In the case of IRB institutions, the own funds requirements on NPEs are made of two components: (i) an RWEA component and (ii) an IRB excess/shortfall own funds adjustment. The risk weight on defaulted exposures is equal to zero for institutions that use supervisory loss given default (LGD) values for their exposures to corporates, institutions, central governments and central institutions (foundation internal rating based or F-IRB institutions). The risk weight should be positive for institutions that have approved models for the own-LGD estimation for their exposures to those types of obligors (advanced internal rating based or A-IRB²² institutions) and/or for their retail exposures, resulting from the difference between the estimated LGD in default (LGDD) parameter (higher) and the estimated expected loss best estimate (EL_{BE}) parameter (lower than, or in exceptional cases equal to, LGDD).
141. The EBA GL on PD estimation, LGD estimation and the treatment of defaulted exposures (EBA/GL/2017/16) further specify what the EL_{BE} and LGDD parameters are intended to capture. A positive difference is expected to arise from the fact that the LGDD reflects, on top of the EL_{BE} given current economic circumstances and exposure status, an estimate of the increase of the loss rate caused by possible additional ULs occurring during the recovery period, i.e. between the date of default and the final liquidation of the exposure, reflecting downturn conditions and a margin of conservatism (both factors should instead not be included in the EL_{BE}). In other words, the difference between LGDD and EL_{BE} determines the level of UL that must be covered by the RWEA-based measure of capital.
142. The IRB excess/shortfall component is such that IRB institutions may add any IRB excess to Tier 2 capital in accordance with Article 62(d) of the CRR or have to deduct any IRB shortfall from CET1 capital in accordance with Article 36(1)(d) of the CRR, under specific limits. The excess/shortfall results from the difference between the NPE-associated EL amounts (or estimated EL_{BE} in the

²² In this report, the reference to 'A-IRB' relates to exposures assigned to the exposure classes in accordance with Article 147(2)(a)-(c) of the CRR in terms of institutions having permission to use own estimates of LGDs and conversion factors and to exposures in accordance with Article 147(2)(d) of the CRR. The term 'F-IRB' refers to exposures assigned to the exposure classes in accordance with Article 147(2)(a)-(c) of the CRR in terms of institutions that have not received permission to use own estimates of LGDs and conversion factors.

case of A-IRB institutions) and the amounts of general credit risk adjustments (CRAs)/SCRAs taken against those exposures. The CRR, as further specified in the EBA RTS on assessment methodology²³, provides that the IRB excess/shortfall calculation should be made for defaulted (NPE) and non-defaulted exposures separately.

143. As assessed by the EBA in the context of its work on the estimation of IRB parameters, and as confirmed by market research evidence, the average risk-weighted component (i.e. the UL component) of the capital requirement on NPE portfolios varies substantially across institutions within the same jurisdiction and across jurisdictions in the EU, from a zero value to relatively high risk weights. Such variability is due, among other reasons, to the documented differences between the F-IRB and A-IRB frameworks and, within the A-IRB framework, to different institutions' practices in the estimation of the EL_{BE} and LGDD parameters. Divergence in practices was also identified by the EBA in relation to the calculation of the IRB excess/shortfall adjustment component.
144. The EBA GL on PD estimation, LGD estimation and the treatment of defaulted exposures, which are expected to lead to a harmonisation of modelling practices for defaulted exposures (NPEs), are to be applied by institutions from 1 January 2021.

Post-securitisation own funds requirements (CRR securitisation framework)

145. For the purposes of assessing the workability of the SRT framework for NPE securitisations, it is essential to consider the role and treatment of the NRPPD absorbed by the originator at the time of the sale of the NPEs. In particular, the following should be borne in mind:
- a) The NPE sale transaction typically exhibits a material gap between the gross book value (GBV) of the portfolio and the sale price, resulting in the NRPPD. The NRPPD is shown in the dark blue area in Figure 6. The NRPPD of the transaction illustrated therein is approximately 79% of the GBV.
 - b) As shown in Figure 7, there are different cost components that determine the NRPPD, only one of which is the investors' cost of capital (i.e. the remuneration for the investment). The example is only illustrative and does not take into account other very relevant factors such as the type of underlying collateral or the jurisdiction governing the transaction's contracts.
 - c) The total exposure value of the securitisation notes issued by the SSPE, amounting to the NPE sale price, may represent only a minor share of the GBV (the orange area in Figure 6 amounts to approximately 21% of the GBV).

²³ See the final RTS published by the EBA in July 2016: [Link](#)

Figure 6: An example of an NPE securitisation transaction

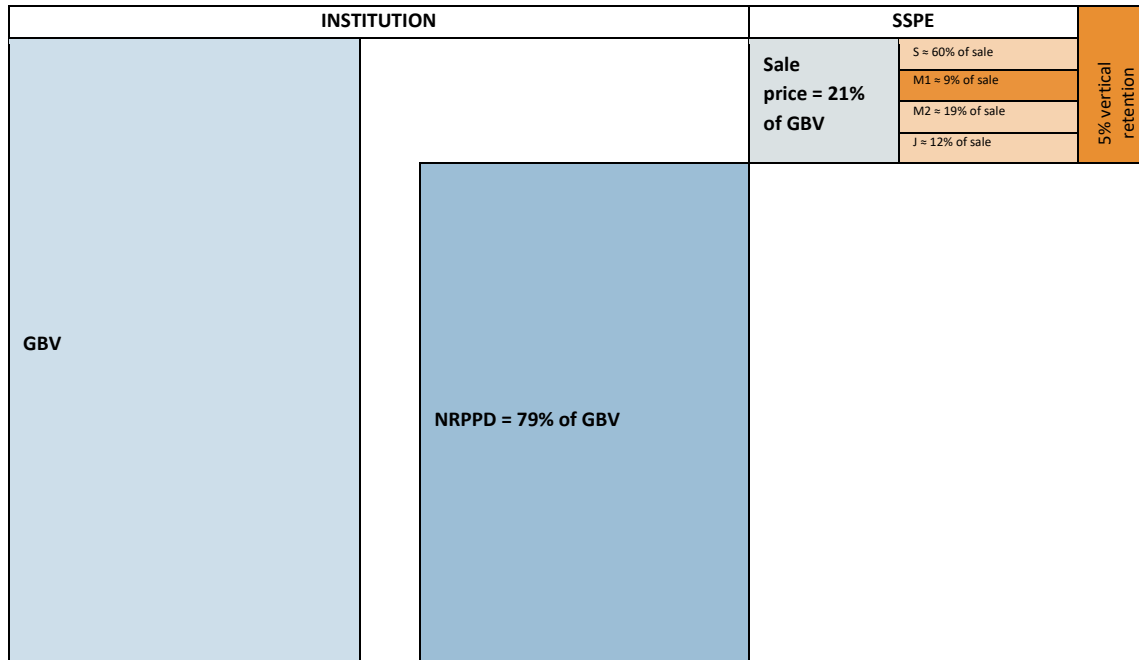
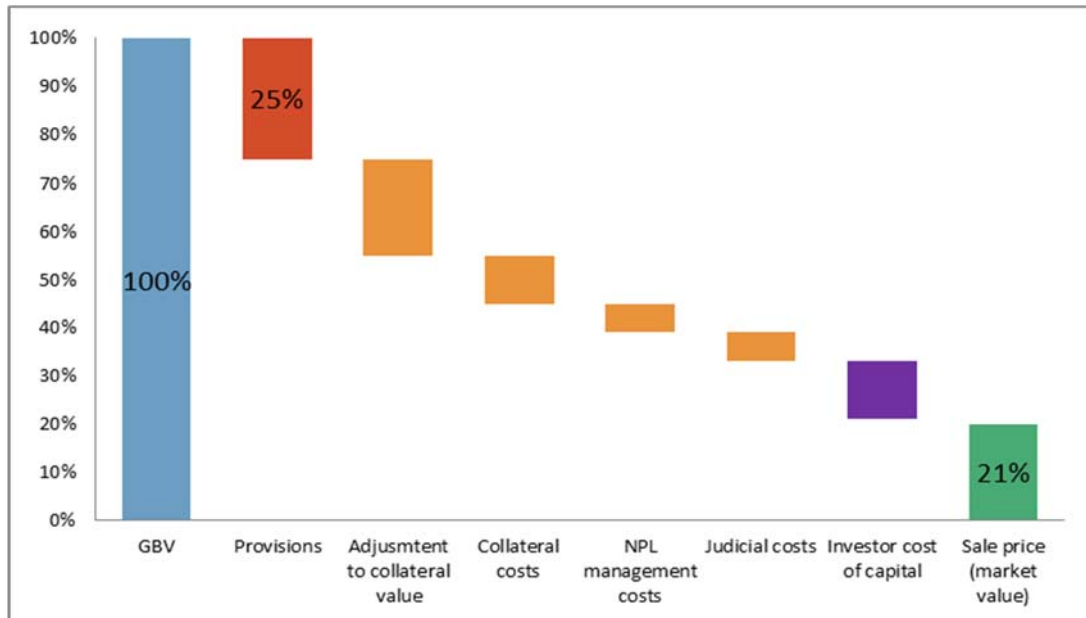


Figure 7: Illustrative example of the breakdown of NRPPD



Sources: Arrow Global and EBA calculations

146. Given the above specificities of NPE securitisation transactions, it is of particular importance to understand how the formulae-based approaches of the EU securitisation framework (i.e. securitisation internal ratings based approach (SEC-IRBA) and securitisation standardised approach (SEC-SA)) apply to NPE securitisation.
147. The formulae-based approaches of the CRR securitisation framework are based on the key principle of non-neutrality. By virtue of this principle, the total capital charge on a securitisation structure, i.e. the sum of the own funds requirements applicable to the individual tranches of the transaction, exceeds the regulatory measures of both the EL and UL risk arising from the underlying portfolio (the K_{IRB} and the K_A ²⁴). To implement the non-neutrality principle, the formulae-based approaches require all tranches that detach below K_{IRB}/K_A (i.e. that cover losses up until K_{IRB}/K_A) to be risk-weighted at 1250%. This is to ensure that the own funds requirements on these tranches fully cover the 1-year ELs and the ULs of the underlying portfolio. The own funds requirements on the remaining tranches, i.e. those attaching above K_{IRB} or K_A , add to the non-neutrality of the overall requirement with risk weights that duly decrease with increasing levels of available credit enhancement.
148. Unlike in securitisation transactions without a significant NRPPD, e.g. most securitisations of performing exposures, in NPE transactions such as the one illustrated in Figure 6, the fundamental question arises as to how the attachment and detachment points of the securitisation tranches should be determined.
149. To answer this question under the assumptions of the formulae-based approaches mentioned here, it is important to recall the rationale of the EU securitisation framework.
150. The securitisation framework in the CRR explicitly introduces the concept of overcollateralisation²⁵, defined as ‘any form of credit enhancement by virtue of which underlying exposures are posted in a value which is higher than the value of the securitisation positions’. If the ‘value’ referenced herein is taken to correspond to the GBV of the loans versus the value of the securitisation positions, this provision should then be understood as giving an explicit credit enhancement role to the overcollateralisation that results from transferring to the SSPE an NPE portfolio of a given GBV to a sale price that is lower than that GBV and that, in turn, determines the nominal value of the securitisation positions issued by the SSPE.
151. The CRR provides in Article 248(1)(d) that the NRPPD on the securitised exposures²⁶ can be deducted by the originator institution from the exposure value associated with securitisation positions that are 1250% risk-weighted/CET1 deducted. The rationale of this deduction is that 1250% risk-weighted/CET1 deducted securitisation positions and specific provisions/NRPPDs

²⁴ K_{IRB} and K_A as calculated in Articles 255 and 261 of the CRR.

²⁵ New Article 242(9) of the CRR.

²⁶ No SCRAs usually remain on balance, as the purpose of an NPE securitisation is to de-recognise the exposures from the accounting balance sheet. In consequence, SCRAs on them are unwound against the hit of the NRPPD in the P&L account.

are both assumed to cover ELs on the securitised exposures. The purpose of this provision is, thus, to avoid the double coverage of EL amounts and to acknowledge a specific role for the NRPPD booked in the P&L of the originator.

152. The CRR securitisation framework builds on the principle that capital requirements on a given transaction should be calculated having regard to the risk profile of the securitised portfolio on the basis of its GBV and, in particular, by assessing which component of that risk has been absorbed by the NRPPD, rather than by focusing in isolation on the volume and risk profile of the securitisation notes issued by the SSPE.
153. As a backdrop to these considerations, the formulae-based approaches to securitisation capital requirements laid out in the CRR securitisation framework are applied on the basis of the GBV of the transaction, i.e. including a credit enhancement role for the NRPPD absorbed by the originator institution. To that end, Article 256(3) of the CRR provides that, for the determination of the attachment and detachment points, institutions must treat the overcollateralisation as a tranche.
154. As a result of the approach taken in Figure 6:
 - a) the most junior tranche of the NPE securitisation structure should be considered to attach at 79% and not at 0%;
 - b) the securitisation tranches receive risk weights that are lower than 1 250%, reflecting the fact that the NRPPD discount acts as a credit enhancement in excess of the K_{IRB}/K_A .
155. The application of the SEC-IRBA in connection with A-IRB portfolios, together with the application of the requirements laid out in the EBA GL on PD estimation, LGD estimation and the treatment of defaulted exposures, should result in higher average measures of underlying portfolio risk (i.e. higher K_{IRB}) on NPE transactions than the supervisory 45%/50% values that apply, respectively, under the SEC-IRBA in connection with F-IRB portfolios and the SEC-SA framework, particularly during downturn conditions. Other things being equal, higher parameters of underlying portfolio risk should result in SEC-IRBA on NPE tranches risk weights based on A-IRB parameters being much higher than SEC-IRBA risk weights based on F-IRB parameters and SEC-SA risk weights.
156. The current CRR securitisation framework fails to take into account the specific features of NPE securitisation, as fully set out in the Opinion of the EBA to the European Commission on the Regulatory Treatment of Non-Performing Exposure Securitisations²⁷, thereby leading to excessive capital requirements for this category of exposures, particularly under the formulae-based approaches. The non-neutrality of the securitisation framework referred to above penalises in excess transactions with high K_{IRB} or K_A , as is the case with NPE securitisations, and

²⁷ EBA opinion to the European Commission on the Regulatory Treatment of NPEs sSecuritisations : [Link](#)

this becomes clear when comparing the risk weights under the securitisation external ratings based approach (SEC-ERBA) with those under the formulae-based approaches. Furthermore, there are asymmetries in risk parameters that have to be considered under SEC-IRBA, depending on whether this approach is applied in connection with F-IRB portfolios or A-IRB portfolios.

157. The Commission, following ongoing work by the Basel Committee on Banking Supervision (BCBS), recently tabled a legislative proposal to remove the existing regulatory constraints on NPE securitisations embedded in the current framework. This proposal, if adopted, would modify the capital treatment of NPE securitisations and define them as securitisations where at least 90% of the exposures in the underlying pool are non-performing within the meaning of Article 47(a) of the CRR.

4.2.3 Recommendations on NPE securitisations

The first-loss test and the mezzanine test

158. As mentioned above, Article 256(3) of the CRR treats the NRPPD as a tranche for the limited purpose of the calculation of attachment and detachment points, following a GBV approach, insofar as the key risk drivers in SEC-SA and SEC-IRB, K_A and K_{IRB} respectively, reflect, or try to reflect in the case of K_A , the EL and UL of the underlying portfolio. In view of this, the question arises whether the NRPPD should be considered the first-loss tranche for the purpose of the first-loss and mezzanine tests.
159. In accordance with point (6) of Article 2 of Regulation (EU) 2017/2402 (the Securitisation Regulation), 'tranche' means 'a contractually established segment of the credit risk associated with an exposure or a pool of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in another segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments'. In turn, in accordance with point (18) of Article 2 of the same Regulation, 'first loss tranche' means 'the most subordinated tranche in a securitisation that is the first tranche to bear losses incurred on the securitised exposures and thereby provides protection to the second loss and, where relevant, higher ranking tranches'.
160. In the light of these definitions, the EBA is of the view that the NRPPD does not fulfil the conditions to be regarded as the securitisation's first-loss tranche. However, and given the usually big difference between the GBV and the NPEs' sale price, and hence the aggregate amount of the securitisation positions, it is unlikely that any first-loss tranche of an NPE securitisation of two tranches would meet the minimum first-loss tranche thickness by itself. Therefore, the risk-absorbing effect of the NRPPD in NPE securitisations should be recognised for the purposes of the minimum first-loss tranche thickness requirement.

Recommendation 16: The first-loss test and the mezzanine test in NPE securitisations

- a) For the purposes of the minimum thickness requirement, the risk-absorbing effect of the NRPPD should be recognised by reducing LTEL + 2/3 of Regulatory UL. Where the risk-absorbing effect of NRPPD exceeds the LTEL + 2/3 of Regulatory UL, this requirement would not apply in practice, as the minimum thickness would be met in all cases regardless of the size of the actual first-loss tranche. In all other cases involving two tranche structures, this requirement would ensure that the first-loss tranche is sufficiently robust to cover the remaining EL and/or a major share of the UL, 80% of the exposure value of which needs to be transferred to third parties.
- b) The first-loss and mezzanine tests should apply with no changes to NPE securitisations. For these purposes, and as explained above, NRPPD should not be considered as the securitisation's first-loss tranche.

A method for the calculation of the LTEL and UL

161. The distinctive feature of NPEs is that there is no need to model LTEL for exposures subject to the A-IRB approach, insofar as LTEL would be the EL_{BE} of the securitised NPEs and the UL would be the positive difference between LGDD and EL_{BE} of the securitised NPEs. However, for exposures subject to the F-IRB approach, the recent Commission's proposal for a specific treatment of NPE securitisations may ban the use of SEC-IRBA for F-IRB exposures in an NPE securitisation. Therefore, in such a case, for consistency reasons, those exposures would be treated as exposures subject to the SA for the purpose of the calculation of LTEL and UL in the SRT assessment.

Recommendation 17: NPE securitisation – calculation of the LTEL and UL

- a) For NPEs subject to the F-IRB approach and for NPEs subject to the SA, LTEL should be the provision that should have been made on the NPEs in accordance with the applicable accounting standards (ECL provisioning), unless the CA does not consider it adequate for the specific case and justifies this accordingly. In such a case, the originator should determine LTEL based on other internal risk parameters to the satisfaction of the CA, such as those considered in its ICAAP.
- b) The UL of the NPE portfolio should be the result of multiplying the RWEAs of the underlying portfolio by the total capital ratio as set out in Article 92 of the CRR. Where the actual level of provisions is lower than the one resulting from the calculation referred to above, the exposure value of the securitised exposures should be adjusted taking into account this higher level of provisions for the purpose of UL calculation. Where the actual level of provisions is higher than

the one resulting from the calculation referred to above, the LTEL would be the actual level of provisions.

- c) To determine the cash flows of the securitised exposures, originators should apply the methodology for NPEs on the asset model as set out in the GL on WAM.

Allocation of LTEL and UL to tranches

162. As with other types of securitisations, originators should model the cash flows of the tranches and the allocation of losses to the tranches in an NPE securitisation based on a cash-flow model, for which originators should use the assumptions on the liability model set out in the GL on WAM.

Treatment of the specific features of an NPE securitisation in the two new tests of commensurateness of the risk transfer

163. The PBA test, which requires a minimum transfer of 50% of the UL of the underlying portfolio to third parties for the transfer of risk to be commensurate, should be adapted for the specific case of NPE securitisations. The reason is that, as mentioned above, in many NPE securitisations the risk-absorbing effect of NRPPD may exceed the LTEL and even two-thirds of Regulatory UL of the securitised portfolio, making it impossible to pass the test, as the actual tranches of the securitisation would have less than 50% of the UL allocated to them. Therefore, the risk-absorbing effect on the UL of NRPPD should be recognised in the PBA ratio.

Recommendation 18: Treatment of the specific features of an NPE securitisation in the two new tests of commensurateness of the risk transfer

- a) The risk-absorbing effect on the UL of NRPPD should be recognised in the denominator of the PBA ratio as offsetting the UL of the securitised portfolio. Where the risk-absorbing effect on the UL of NRPPD is equal to or greater than the UL of the securitised exposures, meaning that there is no remaining UL to be transferred to third parties, the value of the PBA ratio is therefore indeterminate or not meaningful, and the CA should apply additional scrutiny to such cases, making a case-by-case assessment.
- b) Regarding the CRT test, where the first-loss or the mezzanine tranches initially retained by the originator are sold to third parties at a discount immediately after or simultaneously to the transfer of the exposures to the SSPE, that discount on the sale of those tranches that has been recognised in the P&L account should also be included in the post-securitisation capital requirements along with the NRPPD that arose in the transfer of the securitised exposures to the SSPE. Apart from that, no other changes are proposed on the treatment of NPE securitisations for these purposes. The distinct feature of the purpose of the de-recognition of the securitised exposures from the balance sheet of the originator, and its effect in SCRA pre and post securitisation and the NRPPD impact on the P&L account, are already taken into

account for the purposes of Ratio 1. In Ratio 2, the risk-absorbing effect on LTEL and UL of NRPPD is already recognised in the denominator.

164. Without prejudice to the above, the CA should review NPE securitisations in detail, both where the PBA and CRT tests are met, and where the value of the PBA ratio or Ratio 2 of the CRT test is indeterminate or not meaningful, as referred to in paragraph 127. In these cases, before granting the SRT, the CA should conduct a thorough review of the appropriateness of the originator's cash flow projections. If considered useful, the CA may request originators to provide cash flow projections that closely reflect the features of securitised portfolios, their interaction with the legal framework of the Member State concerned, and the actual recovery strategy to be adopted by the servicer. For instance, in the case of portfolios of non-performing mortgage loans, it is important that the cash flow projections appropriately take into account the specificities of the national legal framework as well as the discrimination between assets to be restructured and assets to be liquidated. In addition to the above, it is important that originators provide a precise indication of the fees to be paid to third-party servicers, appropriately discriminating between fixed fees and variable fees, the latter of which directly depend on the level of recoveries. Taken together, cash flow projections and servicing fees will form the basis for assessing transactions' structural costs and the level of coverage of securitisation tranches to which the originator remains exposed (a correct understanding of which is of particular importance).

5. SRT assessment process and standard documentation

5.1 Background: SRT DP findings

165. As the SRT DP noted, the EU regulatory framework does not set out concrete rules on the process for the assessment of SRT. On reviewing the related supervisory practices, the EBA found inconsistencies between CAs as regards:
- a) the requirement on pre- or post-execution SRT notification/application;
 - b) the type and timing of feedback from the respective CA to the originator on whether SRT was met; and
 - c) the types of SRT-related notifications/information.
166. Practices differed across the board on whether *ex ante* notification is required or not. The EBA found that a majority of CAs required originators to submit an SRT notification before execution of the transaction, while only a few required the notification after execution. In either case, deadlines for submitting the relevant notices varied.
167. The inconsistency in CAs' feedback was noted in relation to a minority of Member States, where no feedback or only negative feedback (e.g. failure to meet SRT) was provided to the originator. The type and timing of such feedback also differed, as in some Member States the deadlines were clearly set out in the framework while in others there was no set deadline for the CA to deliver its feedback.
168. Lastly, the SRT DP revealed significant inconsistencies in the types of SRT-related notifications that CAs required submitting and, generally, in the information, data and documents on the securitisation that the originator must make available to start and supplement the SRT assessment process.
169. In the light of these findings, the EBA singled out the above three issues as priority areas for harmonisation of SRT assessment supervisory practices and laid out the following recommendations to foster the harmonisation of SRT assessment supervisory processes:

As a result of the reviewed market practices and range of supervisory practices in relation to the process of SRT assessment, it seems appropriate to further standardise the process in the following core areas:

- a) **SRT notification to the CA:** a formal notification framework should be established, requiring *ex ante* notification by the originator of the SRT transaction at the latest 1 month before the expected issuance. Key information/documentation should be submitted within such *ex ante notification*. The originator should provide a final version of all information/documentation no later than 15 days after the closing date of the transaction;
- b) **supervisory feedback on SRT to the originator:** the CA should provide explicit point-in-time feedback to the originator on whether the SRT has been achieved or not, for each notified SRT transaction. Where no permission is required because one of the quantitative tests is used to demonstrate SRT, the feedback should include a statement of non-objection or objection to the transaction and should be provided within a reasonable timeframe after the submission of the final version of all the information/documentation.

170. Market feedback to the Discussion Paper was highly supportive of greater harmonisation of the SRT assessment process and transparency in supervisory approaches on SRT.

5.2 Supervisory SRT assessment: process recommendations

5.2.1 Rationale for harmonising the SRT assessment process

171. The findings in the SRT DP and the recommendations therein on the SRT assessment process remain fully relevant for the purposes of the mandate laid out in Articles 244(6) and 245(6) of the CRR. Building on these recommendations, this report lays down a set of concrete proposals to establish a harmonised SRT assessment process subject to certain common minimum standards.

172. The ultimate goal of a harmonised SRT assessment process is to facilitate the convergence of supervisory practices in this field, which, in turn, should lead to:

- a) a more transparent and consistent decision-making process by CAs;
- b) enhanced legal certainty for market participants, namely originators and investors in securitisations, insofar as the process would be geared towards delivering clear supervisory feedback on the transaction within a set time period; and
- c) greater product standardisation and a more dynamic securitisation market overall.

173. The above notwithstanding, a harmonised SRT process should not be viewed merely as a box-ticking exercise or as a substitute for supervisory judgement. While process standardisation should help speed up CAs' decision-making, the length and depth of the supervisory assessment should ultimately continue to depend on the complexity of the securitisation subject to review.

5.2.2 Harmonised SRT assessment process: EBA recommendation

174. In the light of the above, the EBA recommends the following:

Recommendation 19: SRT assessment process

- a) The supervisory SRT assessment should be subject to a harmonised process as fully set out in this chapter.
- b) The supervisory SRT assessment should follow a dual-track process that would distinguish between:
 - i. a fast track for ‘qualifying securitisations’, which should be those meeting the criteria set out in section 5.2.3; and
 - ii. a longer and more in-depth review that CAs could apply to ‘non-qualifying securitisations’ (structural features review).
- c) The recommended SRT assessment process should start with the originator submitting an *ex ante* preliminary notice to the CA. The CA should provide the originator with feedback on compliance with SRT by no later than a pre-set deadline. Section 5.2.4 lays down in detail the outline, length and milestones of the recommended process.

5.2.3 Transactions’ qualifying criteria for the fast-track assessment

175. Securitisations meeting the criteria laid out in paragraph 176 should qualify for the fast-track SRT assessment process as described in section 5.2.4. The purpose of these criteria is to single out for the fast-track process securitisations whose SRT can be expected to be more robust and easier to assess due to its standard (normally simpler) features and/or the structural safeguards provided for by the originator, and that would require, as a result, less detailed scrutiny by the CA.
176. **Structural features.** Qualifying securitisations for the fast-track SRT assessment process should include securitisations that are either:
- a) transactions that do not exhibit any of the structural features referred to in Chapter 3 or other complex features not laid out in this report; or
 - b) transactions with any of those structural features, provided that they meet the respective safeguards as laid out in Chapter 3.
177. Notwithstanding the above, CAs should be able to subject ‘first time transactions’ by an originator to a structural features review. These would include an originator’s first ever securitisation or its first securitisation of a certain type or asset class.

178. **Transaction issue size and capital relief materiality.** For a transaction to be a ‘qualifying securitisation’, its issue size should neither:

- a) exceed a pre-defined notional value issuance amount, designed specifically to capture very large transactions, nor
- b) generate a consolidated capital relief for the originator larger than a certain pre-defined threshold measured in basis points.

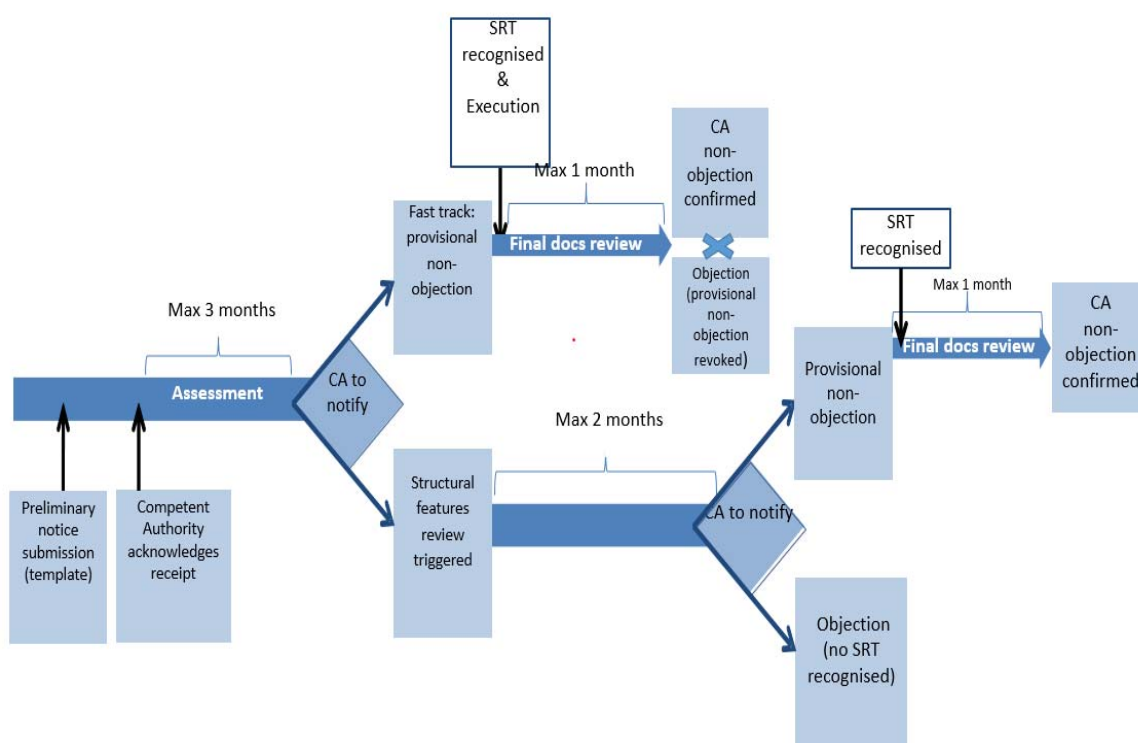
179. Furthermore, these thresholds should be set to capture transactions on both an individual and an aggregate basis for a 1-calendar-year period to prevent transactions from being ‘broken up’ into smaller ones to circumvent the thresholds. Securitisations subject to a tailored fast-track assessment should not count for the purposes of these thresholds (see paragraph 185).

180. **NPE securitisations.** These securitisations should not qualify for the fast-track assessment due to their complexity.

5.2.4 SRT assessment process outline and milestones

181. Figure 8 illustrates the EBA-recommended SRT assessment process:

Figure 8: EBA-recommended SRT assessment process



182. **Preliminary SRT notice (template).** Originators seeking SRT recognition in relation to a securitisation should submit to their CA an SRT notice that provides the necessary preliminary information on the securitisation for the CA to begin the supervisory assessment process. The CA should acknowledge receipt of the SRT notice no later than 7 days from the date on which it was submitted by the originator and indicate whether the notice is complete or, as the case may be, what information is missing (see section 5.3).
183. **SRT assessment length.** The SRT assessment period should start on the date the CA acknowledged receipt of a complete preliminary SRT notice and have a maximum length of 3 months from that date, instead of the 1 month that the SRT DP had suggested. The originator should, therefore, take into account the length of the assessment period and endeavour to submit the SRT notice at the latest 3 months prior to the transaction's projected execution date. Without prejudice to the foregoing, the CA should be able to extend the length of the assessment period up to a maximum of 5 months for securitisations that do not qualify for the fast-track assessment (see paragraph 194 on 'structural features review').
184. The recommended 3-month length of the assessment period is intended to give both CAs and originators ample time and flexibility during the securitisation structuring and negotiation phase ahead of its execution. CAs and originators should maintain a close supervisory dialogue during this period and the CA should endeavour to provide timely feedback on any identified structural impediments (if any) for the securitisation to achieve SRT in such a manner that the originator can discuss those changes with the potential investors in the securitisation well in advance of the transaction's execution date.
185. The above notwithstanding, CAs should be able to agree with originators on a tailored fast-track process whereby the CA would commit to completing the SRT assessment within a shorter period than the generally applicable 3-month-long process. This option should be available for an individual transaction or pre-defined classes or categories of securitisations (e.g. repeat transactions under a programme).
186. **Transaction's draft documents.** The originator should endeavour to submit the transaction's draft documents jointly with the preliminary notice or as soon as possible thereafter. The originator should promptly update and supplement the preliminary SRT notice and the draft securitisation documents initially or subsequently made available to the CA as the transaction structuring progresses (see section 5.3.1).
187. **Freeze period.** By no later than 2 months from the date on which the SRT assessment period commenced, the originator should submit final versions of (i) the SRT test calculations and (ii) the transaction's draft documents. After the start of this 'freeze period', the securitisation's structure and draft documents should not undergo any major changes without the CA's prior consent. Major changes to the securitisation should include, at a minimum, substantially altering the composition of the portfolio, the economics of the transaction or any of its structural features without an appropriate safeguard.

188. The purpose of this ‘freeze period’ is to enable the CA to complete its assessment on a more stable and predictable basis. Where the originator submits the final versions of the abovementioned documents before the end of the 2 months referred to herein, the CA may agree to start the 1-month ‘freeze period’ at that time.
189. **Stopping the clock.** The CA should have the power to stop the SRT assessment period in at least the following cases:
- a) where the originator has failed to submit to the CA the final versions of the draft documents referred to in paragraph 187 for the purposes of starting the freeze period and until such time as the originator submits those;
 - b) where the securitisation’s structure and/or documents are amended after the start of the freeze period and until such time as the CA has reviewed the changes and agrees to restart the clock; where the amendments are of a substantial nature, the CA should be permitted to extend the SRT assessment period for an additional maximum duration of 2 months;
 - c) to direct the originator to make changes to the structure or documentation of securitisation that the CA regards as essential to remove the impediments for the recognition of SRT and until such time as the originator provides evidence that the relevant changes have been implemented; and
 - d) to request any additional information, documentation or clarification from the originator or other transaction parties.
190. **Provisional non-objection.** Following its review of the transaction’s draft documentation, the CA should address a provisional non-objection notice to the originator by no later than the end of the 3-month assessment period where it is satisfied that the transaction meets the conditions for SRT recognition. Where the transaction fails to meet such conditions, the CA should address a notification to the originator stating the reasons for not recognising SRT for the respective transaction.
191. The form and delivery of the pre-execution non-objection notice should be done consistently with the internal procedures applied by the relevant CA. Accordingly and where applicable, the provisional non-objection should be construed as a preliminary technical assessment that would entitle the originator to the expectation of subsequently receiving a consistent non-objection final notice, subject to the review of the transaction’s executed documents and to the decision of the CA’s relevant decision-making body. Based on this expectation, an originator in receipt of a provisional non-objection notice should be entitled to claim capital relief in respect of the securitisation and disclose this circumstance to the market from the date of the transaction’s execution. In the absence of any notification from the CA by the end of the assessment period, the originator should be entitled to claim capital relief in respect of the

securitisation as if it had received a preliminary non-objection notice and with the same expectation of getting a non-objection final notice.

192. **Final decision.** After the securitisation is executed, the originator should submit the transaction's documents to its CA no later than 7 days from the date of execution. The CA should then endeavour to confirm its provisional assessment and address a final non-objection letter to the originator within 1 month of the latter date.
193. Without prejudice to the above, the CA should be able to revoke the preliminary non-objection notice and, instead, object to the securitisation's SRT where the transaction's executed documents deviate materially from the drafts made available during the assessment period or where the assessment was made on the basis of false, insufficient or misleading information. Other than the preceding, after the preliminary non-objection notice has been delivered, the CA is expected to object to the proposed transaction only in limited cases where granting SRT to the transaction could have a severe detrimental effect on the originator's safety and soundness in the judgement of the CA. In this event, the originator would be entitled to exercise the regulatory call referred to in section 2.2.3 of Chapter 3.
194. **Structural features review.** The CA should be able to extend the assessment period length up to a maximum of 5 months to conduct a structural features review on securitisations that do not qualify for fast-track assessment. For these purposes, the CA should address a notice to the originator by no later than the end of the standard 3-month assessment period stating that it has decided to subject the securitisation to a structural features review and the reasons for doing so.
195. In this case, the provisions on the 'freeze period' referred to in paragraph 187 and the 'provisional non-objection' referred to in paragraph 190 should apply *mutatis mutandis* during the extended assessment period for the structural features review. Furthermore, the provisions on the 'final decision' referred to in paragraph 192 should likewise apply to these securitisations after their respective execution dates.
196. **Permission-based process.** Where the provisions on permissions referred to in Articles 244(3) or 245(3) of the CRR apply, the SRT assessment process as laid out herein should broadly apply to the granting of those permissions, subject to the necessary adjustments. For instance, the main difference would be that a permission should be granted as a formal administrative decision at the end of the assessment period instead of a preliminary non-objection notice at staff level. Accordingly, the permission would not be subject to formal confirmation within a set period after the transaction's execution, but the CA should still be able to revoke it in the event that the executed documents deviated materially from the draft documents made available during the assessment period.

5.2.5 SRT assessment of executed securitisations

197. Where an originator executes a securitisation without initially seeking SRT recognition but subsequently applies for it, the same assessment process and conditions as laid out in section 5.2.4 should broadly apply in that case, subject to the necessary changes. For instance, the originator should submit at the same time the preliminary notice and all the executed transaction documents, and the provisions on the ‘freeze period’ should not apply. Furthermore, the provisions on the ‘final decision’ would be moot in this case, as the review of the executed documents and the CA’s final decision on SRT should be made within the assessment period.

5.2.6 Securitisations subject to full deduction

198. These securitisations are currently not subject to notification requirements. Chapter 6, therefore, recommends that Articles 244 and 245 of the CRR be amended to include a requirement on originators making use of this option to notify their CA (see paragraph 217).

5.3 Standard documentation and notifications for SRT assessment and monitoring

5.3.1 Document standardisation

199. As part of the initial recommendations laid out in the SRT DP, it was suggested that ‘key information/documentation’ on the securitisation subject to the SRT assessment should be submitted to the CA with the pre-execution notification. Consistent with those recommendations, this section points to two areas for potential standardisation of documentation: the preliminary SRT notice and the transaction’s documents (including the contractual offering and certain other additional documents).

200. Standardisation of these sets of documents would be instrumental to advancing the objectives of the SRT assessment process harmonisation referred to in paragraph 172, particularly as it would make the process more transparent and accessible to all market participants (namely the new entrants to the securitisation market) and greatly facilitate the consistent decision-making of CAs.

201. Document standardisation, however, should not prevent CAs from requiring the originator to submit additional documents, data, information or clarifications on a given securitisation, where and as appropriate. Furthermore, the originator should submit any updates or supplemental information to the preliminary SRT notice and the transaction’s draft documents as the securitisation structuring progresses or any such new information becomes available and where there are changes to the documents already submitted to the CA.

202. For reasons of technical complexity and considering the required level of detail, it seems inappropriate for the standard SRT assessment documentation to feature in EU or Member States' legislation. For reasons of consistency, such documentation should not be set out by each CA alone. Hence, the Commission may consider requesting that the EBA develop GL on standard SRT assessment documentation to supplement the delegated act in due course. The recommendations set out in this section, therefore, should be regarded as preliminary and subject to development and consultation with the industry as per the process for approval of EBA GL.

Preliminary notice template

203. As provided for in section 5.2.4, the SRT assessment process should start with the originator submitting a preliminary notice on the projected securitisation for which it seeks SRT recognition. The preliminary SRT notice should be drafted in accordance with a common template comprising all the necessary information and data on the projected securitisation for the CA to be able to start its assessment.

204. For the avoidance of doubt, all the information referred to in the notice template should be understood as preliminary and approximate at the time of the notice's submission. In particular, quantitative or statistical information in the SRT preliminary notice should be updated at a later stage with more precise calculations. CAs should be able to waive the provision of information in the notice and begin the SRT process notwithstanding the absence of that information where it considers it appropriate to do so.

205. The following is an indicative list of information and data points for inclusion in the preliminary SRT notice template:

Recommendation 20: Preliminary notice template content

General information

- Identifiers of the securitisation: project name, SPV name, International Securities Identification Numbers.
- Type of securitisation:
 - a) traditional or synthetic;
 - b) term securitisation or ABCP; or
 - c) STS or non-STS.
- Type of underlying exposures: RMBS, CMBS, auto-loans, etc.
- Projected timeline of the transaction.
- List of the transaction's documents (attaching the drafts to the notice if already available).

Portfolio information and data

- Notional size.
- Portfolio's granularity: total number of exposures and effective number of exposures.
- Descriptive statistics of the portfolio. In particular, information on the concentration of securitised exposures by:
 - a) geographical origin;
 - b) exposure class;
 - c) business sector; and
 - d) outstanding balance (as a proportion of the total outstanding balance of all securitised exposures).
- Pre-securitisation capital requirements on the portfolio, including the regulatory capital approach used, input parameters and the portfolio's:
 - a) PD and LGD
 - b) WAL;
 - c) EL and UL and the methodology used to determine them;
 - d) LTEL (%) and the methodology used to determine it; and
 - e) exposures in default (W).

Tranche structure

- Projected securitisation's tranche structure and tranche retention, enclosing information on the following:
 - a) position classes in the waterfall (senior, mezzanine and junior);
 - b) notional size and thickness of each position class;
 - c) expected rating (where applicable);
 - d) risk weights and RWEAs (details of regulatory capital approach to be used and parameters);
 - e) EL allocation;
 - f) EL and UL allocation;
 - g) economic value of the tranches (e.g. sale price or accounting value); and
 - h) for synthetic securitisations, coupon to be paid.
- Structural features relevant to the SRT assessment (see Chapter 3) and, where applicable:
 - a) revolving or rechargeable pool structures;
 - b) obligations or options for originators to repurchase securitised exposures; and
 - c) triggers related to the performance of the securitised exposures or the transaction.
- The currency (or currencies) of issuance and the currency (or currencies) of the securitised exposures. Where there are currency mismatches, full details of any periodic FX resets and any relevant information on how currency risk is to be hedged and managed.

- Where the securitisation features excess spread, its EEVES and the amount of LTEL/UL covered by it.
- Servicing, management and additional collection fees.

SRT tests and risk self-assessment

- Intended SRT test (by reference to relevant provisions of paragraph (2) or (3) of Article 244 or Article 245 of the CRR and applicable delegated act provisions), SRT test calculation and rationale.
- Intended capital relief post securitisation compared with pre-securitisation capital requirements (based on the proposed ratios for the PBA/CRT test; see Chapter 4, section 4.1.1).
- The quantitative risk transfer self-assessment referred to in Chapter 3.

List of standard documents and additional information

206. The following is an indicative list of standard documents that should be submitted to the CA in draft form during the SRT assessment period.

Recommendation 21: Standard documents

- a) The transaction's key contractual documents.
- b) The public offering documentation or investor documentation, as applicable.
- c) Ancillary documents to the transaction's key contractual documents (e.g. bond trust deed, account bank agreements, agency agreement, etc.).
- d) A statement by the originator institution that the transaction meets the conditions for achieving SRT as per Articles 244(2)-(3) or 245(2)-(3) of the CRR and the applicable provisions in the delegated act and the manner in which those conditions are met.
- e) The amount that is intended to be sold on the primary market to investors with close links to the originator (using the definition of 'close links' provided in Article 4(38) of the CRR).
- f) In the case of a privately placed securitisation, the name, type, legal form and country of establishment of potential/actual investors, and whether any of these investors have close links with the originator institution.

- g) For traditional securitisations, an opinion from a qualified legal counsel confirming that the securitised exposures are put beyond the reach of the originator institution and its creditors, including in bankruptcy and receivership.
- h) For synthetic transactions, an opinion from a qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.

207. These documents should be submitted to the CA as early as possible after the start of the SRT assessment period. In particular, the originator should make available in full the documents referred to in (a) and (b) before the end of the first month of the SRT assessment period.

5.3.2 Ongoing reporting on SRT

208. While the SRT DP had recommended additional periodic notifications to the CA for the purpose of monitoring SRT compliance on an ongoing basis, the comprehensive lifetime SRT assessment recommended herein would make such notifications unnecessary. Furthermore, those additional notifications would impose an undue extra burden on originators in the light of the amendments made to the Common Reporting framework (COREP) to report SRT following the Discussion Paper's publication.

209. Originators should, therefore, continue reporting SRT compliance primarily through COREP, updating it as necessary to comply with the relevant provisions in the delegated act. Hence, no separate regular reporting on SRT compliance should be required, without prejudice to the CAs' general power to impose additional or more frequent reporting under the CRD.

210. Without prejudice to the above, the originator should be obliged to promptly notify its CA:

- a) where the assumptions underpinning the SRT assessment have significantly changed, for instance where the transaction is restructured or its terms and conditions are subject to significant changes or in those cases where SRT should be re-assessed as laid out in Chapter 4 (see section 4.1.2 on 'when to run the SRT and CRT tests'); or
- b) in other relevant circumstances, such as where a call option or a time call is exercised or there are circumstances that may indicate implicit support to the securitisation, etc.

6. Recommended amendments to the CRR

211. As alluded to in Chapter 4, the quantitative SRT tests have various important failings. For instance, the mezzanine test fails to target the transfer of the UL in many cases. While specifying the PBA test within the CRT tests in a delegated act would help to address most of those failings, it would be more efficient to replace the current quantitative SRT tests in paragraph 2 of Articles 244 and 245 of the CRR with a test along the lines of the PBA test suggested in Chapter 6.
212. This PBA test could either replicate in the CRR the same features proposed for the delegated act in this report or go beyond and weigh the UL transferred depending on the subordination of the relevant tranches to which the UL is allocated, thus integrating the current requirement of the mezzanine test. This weighting already exists in the current mezzanine test, implying that the transfer of the more subordinated and riskier mezzanine tranches weighs more than that of the more senior tranches for the purposes of passing the test.
213. If the PBA test were laid out directly in the CRR, the SRT assessment could become simpler and more consistent with the underlying assumptions of the current SRT test, as outlined in Chapter 4. Furthermore, certain other current features of the SRT framework in the CRR could be called into a question as a result, for instance the need for a minimum thickness of the relevant tranches or the permission-based process in Articles 244(3) and 245(3) of the CRR, leading to an overall simplification of the framework.
214. In addition, consideration should be given to whether the CRT test would still be needed after the eventual implementation of the PBA test in the CRR. The commensurateness of the risk transfer relies on the principle that a capital relief not justified by a commensurate risk transfer would result in a weakening of the capital position of the institution with respect to the non-securitised exposures. Whether this principle remained valid after the PBA was enshrined in Level 1 could be reassessed.
215. Finally, some other amendments to Chapter 5 of Title II, Part Three of the CRR could be considered to make it more internally coherent. For instance, it would be very relevant for the SRT assessment to adopt a new provision whereby positions attaching below K_{IRB} or K_A , and detaching above K_{IRB} or K_A , would be treated as two positions with attachment equal to K_{IRB} or K_A for the more senior of the positions, as in the repealed Article 266(3)(c) of the CRR under the supervisory formula approach. This is relevant for the SRT because, in its absence, an originator retaining a thick first-loss position that detaches above K_{IRB} or K_A and with a risk weight below 1 250% under the SEC-IRBA or SEC-SA (but likely to be assigned a risk weight of 1 250% under SEC-ERBA), is unable to net the SCRA's on the securitised exposures from the exposure value of

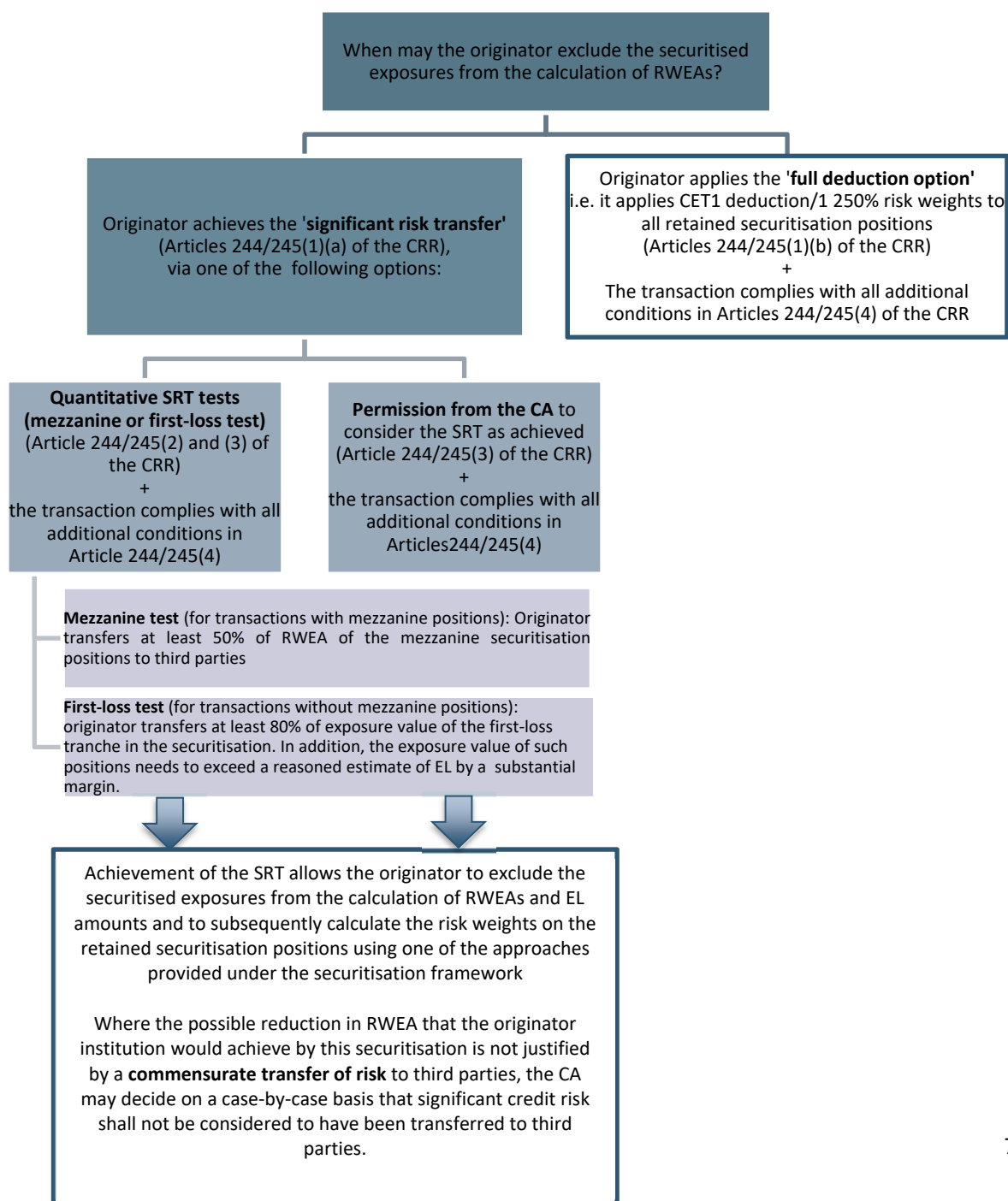
that position, as set out in Article 248(1)(d) of the CRR. In the absence of this provision, the homogeneous application of the CRT test (should it be retained) could not be guaranteed, insofar as the calculation of capital post securitisation in Ratio 1 and the denominator of Ratio 2 would vary depending on whether the SCRA was net from the exposure value of the first-loss tranche retained and the LTEL and UL or not, respectively, as per the relevant approach followed by the originator (either SEC-ERBA or the formulaic approaches).

216. As mentioned in paragraph 118, EEVES should be considered a retained position in the case of synthetic transactions, as it is a commitment by the originator to provide credit enhancement to the protection provider and such a commitment encumbers the originator's P&L account. Therefore, EEVES should be subject to capital requirements as an actual tranche, and that tranche should also be taken into account for the purposes of the calculation of the attachment and detachment point of the rest of the tranches under Article 256 of the CRR. Ongoing work at the BCBS is moving in this direction.
217. As mentioned in paragraph 50, the EBA notes that part of the recommendations on structural features in this report could also be relevant for the purposes of transactions using the full deduction option. These relate to securitisations where the originator makes use of the CET1 deduction or applies 1 250% risk weights on all retained tranches in accordance with point (b) of Articles 244(1) or 245(1) of the CRR, rather than the option (a) of those articles where significant credit risk associated with the underlying exposures has to be transferred to third parties. The full deduction option is not included in the mandate of the EBA under Articles 244(6) or 245(6) of the CRR, but there are some aspects under this option that are not clear, as for example the obligation to notify full deduction transactions or whether certain structural features should also be prohibited due to the impact in the actual transfer of credit risk of the transaction. Therefore, the EBA recommends that Articles 244(4) and 245(4) of the CRR, which state additional conditions that the securitisation should meet, under either point (a) or (b) of Article 244(1) or 245(1), be amended to provide that the requirements proposed for certain structural features pursuant to Chapter 3 (e.g. call options and early termination clauses) apply to securitisations subject to the full deduction option. Furthermore, as mentioned in paragraph 198, these transactions should also be subject to notification requirements, for the CA to be able to assess their compliance with the conditions laid down in Articles 244(4) and 245(4) of the CRR in a timely manner.
218. To avoid heterogeneous supervisory approaches with respect to SRT across Member States and to keep regulatory certainty and a level playing field for institutions transferring risk through securitisation, it is suggested that the EBA should have a monitoring role in relation to new types of structural features of securitisations and SRT, or variations of existing ones, that may appear in the market subsequently to the publication of this report (and the entry into force of the related regulatory or legislative instrument eventually implementing the recommendations included in this report). The EBA should be able to address general recommendations to the CAs and the Commission to ensure a uniform application of the SRT framework as it may be

appropriate, in particular as regards the impact of any such new structural features on the assessment of SRT.

7. Annexes

7.1.1 Annex 1: Options for the originator in the securitisation framework to exclude the securitised exposures from the calculation of risk-weighted exposure amounts and expected loss amounts



7.1.2 Annex 2: Illustrative examples of the allocation of LTEL and UL to the tranches, and of the implementation of the SRT tests

(i) Securitisation of performing exposures

As explained in Recommendation 9(b), to determine the cash flows of the securitised exposures and the EL of each period, originators should use the assumptions on the asset model set out in the GL on WAM, although, for the purposes of the calculation of LTEL, future defaults of the performing portfolio should also be modelled. For the purposes of these examples and for reasons of simplicity, it is assumed that for a traditional securitisation the workout of the defaulted exposures happens in the same year, and, in the case of a synthetic securitisation, that the interim payment of protection corresponding to the defaulted exposures happens in the same period and that it does not differ from the final payment. Regarding the risk retention requirement, it is assumed that the originator is compliant by using the modalities of retention in the securitised exposures.

Asset model

For the purposes of the examples of securitisation of performing exposures, the same underlying portfolio is used, with the following parameters:

General parameters	
Amortisation system	Linear
Amount	EUR 1 000 000
Interest rate	5.0%
CPR	0%

IRB risk parameters	
1-year EL	0.78%
PD	1.73%
UL	4.55%
LGD	45%

By using these parameters, under the evenly loaded scenario mentioned in Recommendation 10(d) (same percentages of PD, where applicable, and EL are applied on the outstanding amount of the securitised exposures every period), the cash flows of the securitised exposures, assuming that all exposures mature at year 7, are the following²⁸:

	0	1	2	3	4	5	6	7	TOTAL
Yearly cash flows		171,472	170,126	168,783	167,441	166,098	164,755	163,928	1,172,604
Principal CF		121,862	126,949	132,240	137,743	143,466	149,417	156,122	967,799
Interest CF		49,610	43,177	36,543	29,697	22,632	15,338	7,806	204,804
Outstanding values	€ 1,000,000	870,338	736,601	598,615	456,202	309,178	157,350	-	
Credit losses		7,800	6,789	5,745	4,669	3,558	2,412	1,227	32,201

Therefore, LTEL of the securitised exposures is EUR 32 201, 3.22% of the outstanding amount of the securitised portfolio at inception.

Using the same securitised portfolio, the following options of securitisation are analysed for illustrative purposes:

- a) traditional securitisation with excess spread and sequential amortisation of the tranches;
- b) synthetic securitisation with fixed SES, UIOLI and pro rata amortisation of the tranches.

STS traditional securitisation with excess spread and sequential amortisation of the tranches

The following structure is assumed, so that the transaction passes the market test mentioned in Recommendation 12 and Recommendation 13, and the risk-absorbing effect of excess spread is fully taken into account in the tests:

Tranche	A	D	Retained	Yield
Senior	6.00%	100.00%	80.00%	1.00%
Mezzanine	1.00%	6.00%	0.00%	6.00%
First-loss	0.00%	1.00%	0.00%	10.00%

For simplicity reasons, no calls are considered in the example.

²⁸ The part that is lost each year is not included in the amortisation and the interest calculation of the following years.

Liability model

In accordance with Recommendation 11, originators should model the cash flows of the tranches and the allocation of losses to the tranches based on a cash-flow model, for which they should use the assumptions on the liability model set out in the GL on WAM.

Therefore, the cash flows from the securitised exposures net of costs and fees of the SSPE²⁹ that feed the waterfall are the following:

0	1	2	3	4	5	6	7	TOTAL
Outcome of the asset model	171,472	170,126	168,783	167,441	166,098	164,755	163,928	1,172,604
Interest CF	49,610	43,177	36,543	29,697	22,632	15,338	7,806	204,804
Principal CF	121,862	126,949	132,240	137,743	143,466	149,417	156,122	967,799
- SSPE costs and fees 1%	10,000	8,703	7,366	5,986	4,562	3,092	1,573	41,283
Total amount payable by the SSPE	161,472	161,423	161,417	161,454	161,536	161,663	162,355	1,131,321

The distribution of those cash flows among the tranches is the following:

		0	1	2	3	4	5	6	7	TOTAL
Senior	Principal CF		129,662	133,738	137,986	142,412	147,024	151,828	97,350	940,000
	Interest CF		9,400	8,103	6,766	5,386	3,962	2,492	973	37,083
	Outstanding values	940,000	810,338	676,601	538,615	396,202	249,178	97,350	-	
Mezz	Principal CF								50,000	50,000
	Interest CF		3,000	3,000	3,000	3,000	3,000	3,000	3,000	21,000
	Outstanding values	50,000	50,000	50,000	50,000	50,000	50,000	50,000	-	
Junior	Principal CF								10,000	10,000
	Interest CF		1,000	1,000	1,000	1,000	1,000	1,000	1,000	7,000
	Outstanding values	10,000	10,000	10,000	10,000	10,000	10,000	10,000		
	Total payments		143,062	145,841	148,752	151,799	154,986	158,320	162,323	1,065,083
	INTEREST		13,400	12,103	10,766	9,386	7,962	6,492	4,973	65,083
	PPAL		129,662	133,738	137,986	142,412	147,024	151,828	157,350	1,000,000
	Excess Spread back to the originator		18,410	15,582	12,665	9,656	6,550	3,343	32	66,238
	Excess Spread absorbing losses		7,800	6,789	5,745	4,669	3,558	2,412	1,227	32,201
	Total Excess Spread		26,210	22,371	18,411	14,325	10,108	5,755	1,259	98,438

As indicated in paragraph 71(a), in a traditional securitisation, the excess spread normally contributes to all interest and principal payments owed by the transaction in accordance with the contractual priority of payments. Remaining excess spread may be returned to the originator or to the investors in the first-loss tranche. In this example, excess spread is covering the EL every year (LTEL = EUR 32 201 in total), and the remaining³⁰ excess spread goes back to the originator³⁰.

²⁹ Cost and fees of the SSPE are assumed to be 1% of the outstanding amount of the securitised exposures each year.

³⁰ The amortisation of the tranches equals the sum of the amortisation of the underlying portfolio and the credit losses, meaning that part of the interest of the portfolio covers those credit losses, thus reducing the excess spread that goes back to the originator. In the first year, although the portfolio amortises EUR 121 862, the tranches amortise EUR 129 662 and

Allocation of LTEL and UL to EEVES and to the tranches

In accordance with Recommendation 10(d), UL should be assumed to occur during the last year of the transaction, after EL has been realised and allocated. This aligns the PBA and the CRT test with the rationale of the SRT tests, which also assume that the junior tranche takes the LTEL first and the mezzanine tranches take the UL afterwards. In addition, from a conceptual point of view, UL is defined as a margin over EL up to a certain quantile, so that early realised losses in a pool contribute to the EL, while later realised losses contribute to the UL. UL should be allocated to tranches in a manner consistent with the allocation of EL, by order of subordination from bottom to top.

In this example, the entire LTEL has been absorbed by EEVES, and the UL of EUR 45 500 is assumed to occur in the last year, with EUR 32 being allocated to the excess spread that would have returned to the originator otherwise, and the rest to the outstanding value of the tranches at the beginning of the last year in order of subordination: EUR 10 000 to the first-loss tranche and the remaining UL to the mezzanine tranche, EUR 35 468.

In accordance with Recommendation 10, for the purposes of the allocation of LTEL and UL to the tranches, the EEVES should be treated as a tranche. EEVES is the size of an equivalent first-loss tranche that would absorb the same amount of losses throughout the life of the transaction under the relevant scenario. Therefore, EEVES is the sum of EUR 32 201 that absorb LTEL, plus EUR 32, which, instead of being returned to the originator in accordance with the model above, would absorb UL: EUR 32 233 in this transaction.

the difference is covered by excess spread. The amount that goes back to the originator is the difference in interest income from the pool and the interest paid to the tranches (EUR 36 210) minus SSPE costs (EUR 10 000) minus credit losses (EUR 7 800), which is EUR 18 410.

PBA and CRT tests

According to Recommendation 12, the **PBA test** is formulated as follows:

PBA test:

$$0.5 \leq \text{Ratio} \frac{\text{Regulatory UL on transferred positions}}{\text{(Regulatory UL of the underlying portfolio)}}$$

Ratio:

- (i) Numerator: the regulatory UL on the transferred positions should take into account the allocation of LTEL and regulatory UL to the tranches in accordance with Recommendation 10. Therefore, in those cases in which the transaction features EEVES- or NRPPD-absorbing losses, the allocation of the UL to the tranches takes into account this circumstance.
- (ii) Denominator: the regulatory UL of the underlying portfolio calculated in accordance with Recommendation 9 – the part of NRPPD that absorbs UL – the part of EEVS that absorbs UL in traditional securitisations if the market test is met.

In this case, the regulatory UL on the transferred positions (first-loss and mezzanine tranches) is EUR 45 468 (45 500 – 32), equalising the regulatory UL on the underlying portfolio, net of the part of EEVES that absorbs UL. As a result, the **PBA ratio is 100% (assuming the market test is met) and the test is passed.**

According to Recommendation 13, the CRT test is formulated as follows:

CRT test:

$$\frac{\text{Ratio 1: } (capital\ presec.) - (capital\ post\ sec.)}{(capital\ presec.)} \leq \frac{\text{Ratio 2: } (Lifetime\ EL + reg.\ UL)\ on\ transfered\ positions}{(Lifetime\ EL + reg.\ UL)\ of\ the\ underlying\ portfolio}$$

Ratio 1:

- (i) the difference between the **own funds requirements pre securitisation** on the whole underlying portfolio calculated according to the general credit risk framework, including EL shortfall where applicable, and SCRA^s on the one hand, and the **own funds requirements post securitisation** calculated in accordance with the securitisation framework corresponding to all credit risk retained by the originator on the other hand, including the SCRA^s that remain on balance and the NRPPD; and
- (ii) the own funds requirements pre securitisation on the whole underlying portfolio calculated according to the general credit risk framework, including EL shortfall where applicable, and SCRA^s.

Ratio 2:

- (i) the LTEL and regulatory UL of the underlying portfolio allocated to securitisation positions transferred to third parties, in accordance with Recommendation 10 – therefore, in those cases in which the transaction features EEVES- or NRPPD-absorbing losses, the allocation of the LTEL and the regulatory UL to the tranches takes into account this circumstance; and
- (ii) the LTEL and regulatory UL of the whole underlying portfolio – the risk-absorbing effect of SCRA^s offset from the EV of a retained tranche subject to a 1 250% risk weight that remains on balance, NRPPD and EEVES in traditional securitisations if the market test is met.

Ratio 2 measures the risk transferred to third parties throughout the life of the transaction. It sums the amount of the LTEL and regulatory UL allocated to all the positions that have been transferred to third parties and compares that amount with the amount of the LTEL and regulatory UL of the securitised portfolio. In this regard, the risk-absorbing effect on the latter of:

- SCRA^s kept on balance after securitisation and offset from the exposure value of a 1 250% risk-weighted tranche retained by the originator;
- the part of NRPPD that absorbs LTEL and UL;
- EEVES in traditional securitisations if the market test is met

should be recognised in the denominator of Ratio 2 by reducing the LTEL and UL of the securitised portfolio.

In this example, one could assume that the level of SCRA matches the 1-year EL of the securitised portfolio at inception, implying that the originator is provisioning the assets in a prudent way. As the originator is providing excess spread to the securitisation on a UIOLI basis, it is unlikely that it achieves accounting de-recognition; therefore, it will continue provisioning the securitised portfolio, and those SCRA should be considered capital post securitisation.

Capital pre securitisation: own funds requirements pre securitisation on the whole underlying portfolio calculated according to the general credit risk framework (**4.55%**), including EL shortfall where applicable **0.78% – 0.78%** and SCRA (**0.78%**) = **5.33%**.

Capital post securitisation: own funds requirements post securitisation calculated in accordance with the securitisation framework corresponding to all credit risk retained by the originator as a percentage of underlying portfolio (80% senior tranche retained with a WAM of 3.91 years³¹ will be subject to a risk weight of 22.70% if STS under SEC-IRBA = **1.37%** capital requirement), including the SCRA that remain on balance (**0.78%**) and the NRPPD (**0%** in this case) = **2.15%**.

Therefore, Ratio 1 = (5.33% – 2.15%)/5.33% = 60%.

Numerator of Ratio 2: risk transferred to third parties (in this case the UL allocated to the first-loss and mezzanine tranches) = **4.55%**.

Denominator of Ratio 2: LTEL (3.22%) + UL (4.55%) – the risk-absorbing effect of EEVES in traditional securitisations if market test is met (3.22%) = **4.55%**.

The market test referred to in Recommendation 12 and Recommendation 13 is met as the originator sold more than 15% of each of the tranches that are not 1 250% risk-weighted.

Therefore, Ratio 2 = 4.55%/4.55% = 100%.

As Ratio 1 ≤ Ratio 2, the CRT test is met.

Synthetic securitisation with fixed UIOLI excess spread and pro rata amortisation of the tranches

The same underlying portfolio considered in the asset model above is synthetically securitised under the following structure:

Tranche	A	D	Retained
Senior	10.00%	100.00%	100.00%
Mezzanine	1.00%	10.00%	0.00%
First-loss	0.00%	1.00%	100.00%

³¹ Although it is not conceptually exact, because WAM should be calculated based on the cash flows of the tranches using an asset and liability model that does not take into account future credit losses, WAM has been calculated using the cash flows of the senior tranche in the example and applying the formula under Article 257(1)(a) of the CRR. The outcome is accurate in this example because of the simplified assumptions and because excess spread covers those losses.

The originator provides 1% fixed UIOLI SES on a yearly basis as credit enhancement to the transaction.

Pro rata amortisation of the tranches. For simplicity reasons no calls, nor triggers changing the amortisation system from pro rata to sequential, are considered in the example.

Liability model

In accordance with Recommendation 10 and Recommendation 11, originators should model the cash flows of the tranches and the allocation of losses to the tranches based on a cash-flow model, for which they should use the assumptions on the liability model set out in the GL on WAM. The cash flows should consist of the contractual payments that are to be allocated to tranches in accordance with the terms and conditions of the transaction (i.e. allocation of the amortisation of the securitised exposures to the tranches and premiums paid on the protected tranches).

In this example, the interest income from the securitised exposures and the premiums paid to the protection providers do not affect the analysis, as SES is a fixed amount. If it were a variable amount mimicking excess spread in a traditional securitisation, their cash flows should also be considered as in the previous example of a traditional securitisation to determine EEVES.

The distribution of those cash flows among the tranches is the following:

		0	1	2	3	4	5	6	7	TOTAL
Senior	Principal CF		116,696	120,364	124,187	128,171	132,322	136,645	141,615	900,000
	Outstanding values	900,000	783,304	662,940	538,753	410,582	278,260	141,615	-	
Mezz	Principal CF		11,670	12,036	12,419	12,817	13,232	13,665	14,161	90,000
	Outstanding values	90,000	78,330	66,294	53,875	41,058	27,826	14,161	-	
First Loss	Principal CF		1,297	1,337	1,380	1,424	1,470	1,518	1,573	10,000
	Outstanding values	10,000	8,703	7,366	5,986	4,562	3,092	1,573		
	TOTAL Principal CF		129,662	133,738	137,986	142,412	147,024	151,828	157,350	1,000,000
	Excess Spread back to the originator		2,200	1,915	1,621	1,317	1,004	680	346	9,082
	Excess Spread absorbing losses		7,800	6,789	5,745	4,669	3,558	2,412	1,227	32,201
	Total Excess Spread	1%	10,000	8,703	7,366	5,986	4,562	3,092	1,573	41,283

As indicated in paragraph 71, in a synthetic securitisations the excess spread may be used as the most subordinated form of credit enhancement. In this example, excess spread covers the EL every year (LTEL = EUR 32 201 in total). In consequence, the remaining excess spread goes back to the originator.

Allocation of LTEL and UL to tranches

In accordance with Recommendation 10, UL should be assumed to occur during the last year of the transaction, after EL has been realised and allocated. As mentioned previously, this aligns the PBA and the CRT test with the rationale of the SRT tests, which also assume that the junior tranche takes the LTEL first and the mezzanine tranches take the UL afterwards. In addition, from a conceptual point of view, UL is defined as a margin over EL up to a certain quantile, so that early realised losses in a pool

contribute to the EL, while later realised losses contribute to the UL. UL should be allocated to tranches in a manner consistent with the allocation of EL, by order of subordination from bottom to top.

The entire LTEL has been absorbed by EEVES, and the UL of EUR 45 500 is assumed to occur in the last year, with EUR 346 being allocated to the excess spread that would have returned to the originator otherwise and the rest to the outstanding value of the tranches at the beginning of the last year in order of subordination: EUR 1573 to the first-loss tranche, EUR 14 161 to the mezzanine tranche, and the remaining UL, EUR 29 419, to the senior tranche.

In accordance with Recommendation 10, for the purposes of the allocation of LTEL and UL to the tranches, the EEVES should be treated as a tranche. EEVES is the size of an equivalent first-loss tranche that would absorb the same amount of losses throughout the life of the transaction under the relevant scenario. Therefore, EEVES is the sum of EUR 32 201 that absorb LTEL, plus EUR 346, which instead of being returned to the originator in accordance with the model above would absorb UL: EUR 32 547 in this transaction.

PBA and CRT tests

According to Recommendation 12, the **PBA test** is formulated as follows:

PBA test:

$$0.5 \leq \text{Ratio} \frac{\text{Regulatory UL on transferred positions}}{\text{(Regulatory UL of the underlying portfolio)}}$$

In this case, the regulatory UL on the transferred positions (mezzanine tranche only) is EUR 14 161, well below the regulatory UL on the underlying portfolio; therefore, the **PBA ratio is 31% (14 161/45 500) and the test is not passed.**

CRT test:

$$\frac{(\text{capital presec.}) - (\text{capital post sec.})}{(\text{capital presec.})} \leq \frac{\text{Ratio 1:} \leq \text{Ratio 2:} \frac{(\text{Lifetime EL} + \text{reg. UL}) \text{ on transferred positions}}{(\text{Lifetime EL} + \text{reg. UL}) \text{ of the underlying portfolio}}}$$

Regarding the PBA and CRT tests, as indicated in Recommendation 10, EEVES should be considered a retained position in the case of synthetic transactions, as it is a commitment by the originator to provide credit enhancement to the protection provider, and such a commitment encumbers the originator's P&L account. However, EEVES in synthetic securitisations is not subject to capital

requirements. Consequently, EEVES is not considered in the calculation of capital post securitisation in Ratio 1, but it is considered a retained position of the originator in Ratio 2.

As in the previous example, one could assume that the level of SCRAs matches the 1-year EL of the securitised portfolio at inception, implying that the originator is provisioning the assets in a prudent way. As the securitised portfolio remains on balance, the originator will continue provisioning the securitised portfolio and those SCRAs should be considered capital post securitisation. However, as the originator is retaining the first-loss tranche, subject to a 1250% risk weight, following Article 248(1)(d), the originator may deduct from the exposure the amount of the SCRAs on the underlying exposures.

Consequently:

Capital pre securitisation: own funds requirements pre securitisation on the whole underlying portfolio calculated according to the general credit risk framework (**4.55%**), including EL shortfall where applicable (**0.78% – 0.78%**), and SCRAs (**0.78%**) = **5.33%**

Capital post-securitisation: own funds requirements post securitisation calculated in accordance with the securitisation framework corresponding to all credit risk retained by the originator as a percentage of the securitised portfolio (100% senior tranche retained with a WAM of 4.13 years will be subject to a risk weight of 25.81% under SEC-IRBA as it is not STS = **1.86%** capital requirement; and 100% of the FL tranche subject to a 1250% risk weight net of SCRAs = **0.22%** capital requirement), including the SCRAs that remain on balance (**0.78%**) = **2.86%**.

Therefore, Ratio 1 = (5.33% – 2.86%)/5.33% = 46%.

Numerator of Ratio 2: risk transferred to third parties (in this case the UL allocated to the mezzanine tranche only) = **1.42%**.

Denominator of Ratio 2: LTEL (3.22%) + UL (4.55%) = **7.77%**.

Therefore, Ratio 2 = 1.42%/7.77% = 18.2%.

As Ratio 1 > Ratio 2, the CRT test is not met.

This example shows that, generally speaking, passing the PBA and CRT tests is unlikely for transactions featuring a pure pro rata amortisation system of the tranches. If this example had considered a trigger for switching from pro rata to sequential, the outstanding value of the mezzanine tranche in the last period would have been larger, as would the allocation of UL to that tranche, and both tests might have been passed.

(ii) Securitisation of non-performing exposures

As per Recommendation 17, to determine the cash flows of the securitised exposures, originators should apply the methodology for NPEs on the asset model as set out in the GL on WAM. Although institutions do not need the model to calculate LTEL, which equals EL_{BE} in the case of A-IRB exposures, or the provisions that should have been made on the NPEs in accordance with the applicable accounting standards (ECL provisioning) in the case of SA exposures, except where the CA does not consider it adequate for the specific case and justifies this accordingly as indicated in Recommendation 17, the asset model is needed to implement the liability model.

Asset model

For the purposes of the examples of securitisation of NPEs, the same underlying portfolio is used, with the following parameters:

A-IRB risk parameters		SA risk parameters	
Purchase price discount	79%	Purchase price discount	79%
PD	100%	% of defaulted loans	100%
Effective LGD (ELGD)	72%	UL	8% (100% risk weight \times 8%) ³²
EL_{BE}	70%	SCRAs	70%

By using these parameters and the specifications in the GL on WAM on NPE exposures, the cash flows of the securitised exposures are assumed to be the following³³:

³² The EBA published in October 2019 an Opinion to the European Commission on the Regulatory Treatment of Non-Performing Exposure Securitisations. According to the opinion, the applicable risk weight for SEC-SA purposes should be 100% where the originator was able to apply that same risk weight on the underlying portfolio pre securitisation in accordance with Article 127 of the CRR and the NRPPD exceeds the percentage of SCRAs made by the originator as set out in that article. NRPPD matching the SCRAs would be equally valid.

³³ It is assumed that there is a recovery plan adapted to the different characteristics of the NPE exposures in accordance with the specifications of the asset model in the GL on WAM.

	0	1	2	3	4	5	6	7	TOTAL
Yearly cash flows		36,000	75,000	60,000	45,000	30,000	24,000	30,000	300,000
Recoveries		36,000	75,000	60,000	45,000	30,000	24,000	30,000	300,000
Interest CF									-
Outstanding value	€ 1,000,000	880,000	630,000	430,000	280,000	180,000	100,000	-	
Credit losses		84,000	175,000	140,000	105,000	70,000	56,000	70,000	700,000

Liability model

For the purposes of the examples of securitisation of NPEs, the same liability model is used, with the following structure:

Tranches	A	D	Retained	Yields
Senior	91.00%	100.00%	100.00%	2.00%
Mezzanine	82.00%	91.00%	0.00%	7.00%
First-loss	79.00%	82.00%	0.00%	11.78%
NRPPD	0.00%	79.00%		

Pro rata amortisation³⁴. SSPE costs and fees add up to 0.90% of the GBV at the beginning of each period. For reasons of simplicity, no calls are considered in the example.

In accordance with paragraph 162, originators should model the cash flows of the tranches and the allocation of losses to the tranches based on a cash-flow model, for which they should use the assumptions on the liability model set out in the GL on WAM.

Therefore, the cash flows from the securitised exposures net of costs and fees of the SSPE that feed the waterfall are the following:

	1	2	3	4	5	6	7	TOTAL
Outcome of the asset model	36,000	75,000	60,000	45,000	30,000	24,000	30,000	300,000
Recoveries CF	36,000	75,000	60,000	45,000	30,000	24,000	30,000	300,000
- SSPE costs and fees 0.9%	9,000	7,920	5,670	3,870	2,520	1,620	900	31,500
Total amount payable by the SSPE	27,000	67,080	54,330	41,130	27,480	22,380	29,100	268,500

³⁴ Sequential amortisation in an NPE securitisation means that all senior interest and principal payments are fully paid out before any cash goes to the mezzanine tranche or the first-loss tranche. In this example, mezzanine and first-loss notes receive interest payments before the senior principal is repaid, and the amortisation system would be considered pro rata for the purposes of the triggers indicated in paragraph 57.

The distribution of those cash flows among the tranches is as follows:

		0	1	2	3	4	5	6	7	TOTAL
Senior	Principal CF		15,366	55,753	18,881					90,000
	Interest CF		1,800	1,493	378	-	-	-	-	3,670
	Outstanding value	90,000	74,634	18,881	-	-	-	-	-	
Mezz	Principal CF				25,238	33,063	21,727	9,973	-	90,000
	Interest CF		6,300	6,300	6,300	4,533	2,219	698	-	26,350
	Outstanding value	90,000	90,000	90,000	64,762	31,700	9,973	-	-	
First Loss	Principal CF							8,175	21,825	30,000
	Interest CF		3,534	3,534	3,534	3,534	3,534	3,534	2,572	23,776
	Outstanding value	30,000	30,000	30,000	30,000	30,000	30,000	21,825	-	
	Total payments		27,000	67,080	54,330	41,130	27,480	22,380	24,397	263,797
	INTEREST		11,634	11,327	10,212	8,067	5,753	4,232	2,572	53,797
	PPAL		15,366	55,753	44,118	33,063	21,727	18,148	21,825	210,000

NPE securitisation: A-IRB securitised exposures

Allocation of LTEL and UL to tranches

In accordance with Recommendation 10, UL should be assumed to occur during the last year of the transaction, after EL has been realised and allocated. UL should be allocated to tranches in a manner consistent with the allocation of EL, by order of subordination from bottom to top. See below the outstanding amounts of securitised assets, credit losses, tranches and NRPPD throughout the life of the deal.

SSPE balance sheet summary

<u>Asset side</u>	1	2	3	4	5	6	7
securitised exposures	880,000	630,000	430,000	280,000	180,000	100,000	-
credit losses realised (Accrued)	84,000	259,000	399,000	504,000	574,000	630,000	700,000
interest paid + costs (Accrued)	20,634	39,881	55,762	67,700	75,973	81,825	85,297
cash							4,703
	984,634	928,881	884,762	851,700	829,973	811,825	790,000
<u>Liability side</u>							
senior	74,634	18,881	-	-	-	-	-
mezz	90,000	90,000	64,762	31,700	9,973	-	-
first loss	30,000	30,000	30,000	30,000	30,000	21,825	-
NRPPD	790,000	790,000	790,000	790,000	790,000	790,000	790,000
	984,634	928,881	884,762	851,700	829,973	811,825	790,000

Recoveries net of costs and fees and interest expenses are the amount available to cover the principal repayment of the tranches. When credit losses or costs and fees are lower than expected, there is an increase in the amount available to cover the principal repayment of the tranches. In this example, there is an excess of EUR 4 703 in that amount in the last year, as the total amount payable by the SSPE net of interest payments is EUR 26 528 (EUR 29 100 – EUR 2 572) and the amortisation payment of the remaining tranche is EUR 21 825.

The UL of EUR 20 000 in the A-IRB portfolio, which is assumed to occur in the last year, will reduce the total amount payable by the SSPE net of interest payments to EUR 6 528, and the first-loss tranche will take a loss of EUR 15 297. The rest of the UL, EUR 4 703, is attributed to the NRPPD, which is in excess of the LTEL, and the costs and fees and the interest payments in that amount, as explained in the previous paragraph. That amount that would have been paid to the holder of the first-loss tranche or the servicer otherwise in accordance with the transaction documentation. NRPPD is also absorbing the full LTEL of the underlying portfolio.

PBA and CRT tests

According to Recommendation 12 and Recommendation 18, the **PBA test** is formulated as follows:

PBA test:

$$0.5 \leq \text{Ratio} \frac{\text{Regulatory UL on transferred positions}}{\text{(Regulatory UL of the underlying portfolio)}}$$

In this case of an A-IRB portfolio, the regulatory UL on the transferred positions (first-loss tranche) is EUR 15 297 and the regulatory UL of the underlying portfolio net of the part absorbed by the NRPPD is also EUR 15 297 (20 000 – 4 703). As a result, the **PBA ratio is 100%**.

According to Recommendation 13 and Recommendation 18, the CRT test is formulated as follows:

CRT test:

$$\frac{(\text{capital presec.}) - (\text{capital post sec.})}{(\text{capital presec.})} \leq \frac{\text{Ratio 1:} \leq \text{Ratio 2:} \quad (\text{Lifetime EL} + \text{reg. UL}) \text{ on transferred positions}}{(\text{Lifetime EL} + \text{reg. UL}) \text{ of the underlying portfolio}}$$

Capital pre securitisation: own funds requirements pre securitisation on the whole underlying portfolio calculated according to the general credit risk framework (**2%**), including EL shortfall where applicable (**70% – 70%**), and SCRAAs (**70%**) = **72%**.

Capital post securitisation: own funds requirements post securitisation calculated in accordance with the securitisation framework corresponding to all credit risk retained by the originator (100% senior tranche retained with a WAM of 2.05 years will be subject to a risk weight of 424.18% under SEC-IRBA, capped at 118% in accordance with the interpretation of the risk-weight cap of Article 267 of the CRR provided by the EBA³⁵ = **0.86%** capital requirement as a percentage of GBV), including the NRPPD (**79%** in this case) = **79.86%**.

Therefore, Ratio 1 = (72% – 79.86%)/72% = –11%.

Numerator of Ratio 2: risk transferred to third parties (in this case the UL allocated to the FL tranche) = **1.53%** as a percentage of the GBV.

Denominator of Ratio 2: LTEL (70%) + UL (2%) – the loss absorbing effect of NRPPD (70.47%) = **1.53%**.

Therefore, Ratio 2 = 100%.

As Ratio 1 ≤ Ratio 2, the CRT test is therefore met.

NPE securitisation: SA securitised exposures

The difference from the case of A-IRB exposures is that the UL is higher in the case of SA exposures and, consequently, the allocation of the UL to the tranches changes.

Allocation of LTEL and UL to tranches

In accordance with Recommendation 10, UL should be assumed to occur during the last year of the transaction, after EL has been realised and allocated. This aligns the PBA and the CRT test with the rationale of the SRT tests, which also assume that the junior tranche takes the LTEL first and the mezzanine tranches take the UL afterwards. In addition, from a conceptual point of view, UL is defined as a margin over EL up to a certain quantile, so that early realised losses in a pool contribute to the EL, while later realised losses contribute to the UL. UL should be allocated to tranches in a manner consistent with the allocation of EL, by order of subordination from bottom to top.

However, the cash flows of the last year of the transaction, calculated in the asset model using ELs only, are not enough to cover the UL of 80 000 under the SA. Therefore, the additional losses should be added to the asset model backwards from the last year.

- ³⁵ EBA Opinion to the European Commission on the Regulatory Treatment of NPEs securitisations.

Adjusted asset model including UL

	€	1,000,000	12%	25%	20%	15%	10%	8%	10.00%	
		0	1	2	3	4	5	6	7	TOTAL
Yearly cash flows			36,000	75,000	60,000	45,000	4,000	-	-	220,000
Recoveries			36,000	75,000	60,000	45,000	4,000	-	-	220,000
Outstanding values	€	1,000,000	880,000	630,000	430,000	280,000	180,000	100,000	-	
Credit losses			84,000	175,000	140,000	105,000	96,000	80,000	100,000	780,000

Credit losses include LTEL and UL now.

Subsequently, the adjusted cash flows from the securitised exposures net of costs and fees of the SSPE that feed the waterfall are the following:

	1	2	3	4	5	6	7	TOTAL
Outcome of the asset model	36,000	75,000	60,000	45,000	4,000	-	-	220,000
Recoveries CF	36,000	75,000	60,000	45,000	4,000	-	-	220,000
- SSPE costs and fees 0.9%	9,000	7,920	5,670	3,870	2,520			28,980
Total amount payable by the SSPE	27,000	67,080	54,330	41,130	1,480	-	-	191,020

Adjusted liability model including UL

The distribution of those cash flows among the tranches, taking into account the UL now, are the following:

		0	1	2	3	4	5	6	7	TOTAL
Senior	Principal CF		15,366	55,753	18,881					90,000
	Interest CF		1,800	1,493	378	-	-	-	-	3,670
	Outstanding values	90,000	74,634	18,881	-	-	-	-	-	
Mezz	Principal CF				25,238	33,063				58,300
	Interest CF		6,300	6,300	6,300	4,533	1,480			24,913
	Outstanding values	90,000	90,000	90,000	64,762	31,700	31,700	31,700	31,700	
First Loss	Principal CF									-
	Interest CF		3,534	3,534	3,534	3,534				14,136
	Outstanding values	30,000	30,000	30,000	30,000	30,000	30,000	30,000	30,000	
	Total payments		27,000	67,080	54,330	41,130	1,480	-	-	191,020
	INTEREST		11,634	11,327	10,212	8,067	1,480	-	-	42,720
	PPAL		15,366	55,753	44,118	33,063	-	-	-	148,300

SSPE balance sheet summary (UL adjusted)

Asset side	1	2	3	4	5	6	7	LTEL	UL
securitised exposures	880,000	630,000	430,000	280,000	180,000	100,000	-		
credit losses realised (Accrued)	84,000	259,000	399,000	504,000	600,000	680,000	780,000	700,000	80,000
interest paid + costs (Accrued)	20,634	39,881	55,762	67,700	71,700	71,700	71,700		
cash							-		
	984,634	928,881	884,762	851,700	851,700	851,700	851,700		
Liability side									
senior	74,634	18,881	-	-	-	-	-		
mezz	90,000	90,000	64,762	31,700	31,700	31,700	31,700		31,700
first loss	30,000	30,000	30,000	30,000	30,000	30,000	30,000		30,000
NRPPD	790,000	790,000	790,000	790,000	790,000	790,000	790,000	700,000	18,300

Consequently, in this example, the entire LTEL has been absorbed by NRPPD and, as the UL of EUR 80 000 is assumed to occur in the last 3 years:

- EUR 18 300 of UL are allocated to the NRPPD (NRPPD of EUR 790 000 covers EUR 700 000 LTEL, EUR 71 700 costs and fees of the SSPE and interest paid, resulting in an excess of EUR 18 300), an amount that would have been paid to the holder of the first-loss tranche or the servicer otherwise; and
- the rest of the UL is allocated to the outstanding value of the tranches at the maturity of the transaction in order of subordination: EUR 30 000 to the first-loss tranche and EUR 31 700 to the mezzanine tranche.

PBA and CRT tests

According to Recommendation 12 and Recommendation 18, the **PBA test** is formulated as follows:

PBA test:

$$0.5 \leq \text{Ratio} \frac{\text{Regulatory UL on transferred positions}}{(\text{Regulatory UL of the underlying portfolio})}$$

In this case of an SA portfolio, the regulatory UL on the transferred positions (first-loss and mezzanine tranches) is EUR 61 700, and the regulatory UL of the underlying portfolio net of the part absorbed by the NRPPD is EUR 61 700 as well (EUR 80 000 – EUR 18 300). As a result, the **PBA ratio is 100%**.

According to Recommendation 13 and Recommendation 18, the CRT test is formulated as follows:

CRT test:

Ratio 1: ≤ Ratio 2:

$$\frac{(\text{capital presec.}) - (\text{capital post sec.})}{(\text{capital presec.})} \leq \frac{(\text{Lifetime EL} + \text{reg. UL}) \text{ on transferred positions}}{(\text{Lifetime EL} + \text{reg. UL}) \text{ of the underlying portfolio}}$$

Capital pre securitisation: own funds requirements pre securitisation on the whole underlying portfolio calculated according to the general credit risk framework (8%) and SCRA (70%) = 78%.

Capital post securitisation: own funds requirements post securitisation calculated in accordance with the securitisation framework corresponding to all credit risk retained by the originator (100% senior tranche retained will be subject to a risk weight of 503.83% under SEC-SA, capped at 100% in accordance with the interpretation of the risk-weight cap of Article 267 of the CRR provided by the EBA³⁶ = 0.72% capital requirement as a percentage of GBV), including the NRPPD (79% in this case) = 79.72%.

Therefore, Ratio 1 = (78% – 79.72%)/78% = –2%.

Numerator of Ratio 2: risk transferred to third parties (in this case the UL allocated to the first-loss and mezzanine tranches) = 6.17% as a percentage of the GBV.

Denominator of Ratio 2: LTEL (70%) + UL (8%) – the loss-absorbing effect of NRPPD (71.83%) = 6.17%.

Therefore, Ratio 2 = 100%.

As Ratio 1 ≤ Ratio 2, the CRT test is therefore met.

(iii) Securitisation of SA performing exposures

The examples provided above that have been designed for A-IRB underlying portfolios and the calculation of capital requirements under the SEC-IRBA can be easily adapted to the case of SA portfolios by replacing the A-IRB risk parameters by the risk parameters corresponding to an SA portfolio as indicated in Recommendation 9, and SEC-IRBA by SEC-SA or SEC-ERBA in the calculation

³⁶ EBA opinion to the European Commission on the Regulatory Treatment of NPE securitisations.

of the capital post securitisation on the retained positions, in the same manner as has been shown in the example of SA NPEs above.



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