DRAFT REGULATORY TECHNICAL STANDARDS SPECIFYING THE DETERMINATION BY ORIGINATOR INSTITUTIONS OF THE EXPOSURE VALUE OF SYNTHETIC EXCESS SPREAD (SES) PURSUANT TO ARTICLE 248(4) OF CRR

Public Hearing, 6 September 2022

Public Hearing on draft RTS on the exposure value of synthetic excess spread (SES)
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Mandate and Background

- **Article 248(4) CRR.** The Capital Markets Recovery Package (CMRP), which amended the Securitisation Regulation and the CRR, mandated the EBA to **develop draft RTS to specify** how an originator in a synthetic securitisation shall determine **the exposure value of SES** in Article 248(3a) of the CRR) **taking into account the relevant losses expected to be covered by the SES**

- In accordance with the amended Article 2 of the Securitisation Regulation, **SES means the amount that**, according to the documentation of a synthetic securitisation, **is contractually designated by the originator to absorb losses of the securitised exposures that might occur before the maturity date of the transaction**

- With the aim of **making the securitisation framework more risk sensitive at both ends of the structure of a synthetic securitisation**, the CMRP included a **preferential treatment for the senior tranches of STS synthetic securitisations** retained by the originator and, at the same time, imposed an **exposure value on SES**. The latter to address concerns on regulatory arbitrage

- Recital 11 of the CRR amendment explains that the **regulatory arbitrage** 'occurs when an originator institution provides credit enhancement to the securitisation positions held by protection providers by contractually designating certain amounts to cover losses of the securitised exposures during the life of the transaction, and **such amounts, which encumber the originator institution's income statement in a manner similar to unfunded guarantee, are not risk-weighted**'.

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Article 248(1)(e) and 256 CRR

- Art. 248(1)(e) specifies that SES shall be considered a securitisation position and describes **which elements should be included in the exposure value of SES**. These elements comprise of:

    (i) any income from the securitised exposures recognised by the originator institution in its income statement available to absorb losses,

    (ii) any SES contractually designated by the originator in any previous periods or

    (iii) for the current period available to absorb losses, and

    (iv) any SES contractually designated by the originator for future periods.

- Art. 256 requires that the originator institution treats the **exposure value of the securitisation position corresponding to SES as a tranche** for the purposes of calculating the attachment and detachment points of the securitisation position it retains.

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RTS Article 2: Calculation of the exposure value of SES

Exposure value of SES as the sum of the exposure values resulting from points (i) to (iv).

- For that purpose, the exposure values of the SES referred to in points (i) to (iii) (**SES already available to absorb losses) shall be equal to the entire amount** of the SES referred to in these points.

- **SES** contractually designated by the originator institution for **all future periods within the expected maturity of the transaction** as referred to in point (iv). Originator institutions shall apply either of the following **approaches** for the calculation:

  (a)   a **full model approach**

  (b)   a **simplified model approach**

  Originator institutions shall decide to apply either of the approaches consistently to all their securitisations featuring SES

'Expected maturity of the transaction' (Art. 1 on definitions) means:

- the **contractual maturity of the credit protection** agreement or

- the **earliest date at which the originator is allowed to exercise an option to terminate the protection**, or a clean-up, that allows early termination of the protection agreement before its contractual maturity

- The expected maturity of the transaction shall be **subject to a maximum of 5 years**.

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RTS: SES for future periods

The RTS deals with **different types of SES** for future periods:

- **Fixed amount** or

- **Variable amount**, depending either:

  ➢ on the income of the securitised exposures (**ex-post SES**, which mirrors excess spread in traditional securitisations) or

  ➢ on the outstanding amount of them, in each of the future periods.

In both cases, it can be under:

- an **'use-it-or-lose-it' (UIOLI)** mechanism, where any amount of the SES designated by the originator institution for a particular period that is not used for loss absorption in that period is no longer available for loss compensation in future periods, or

- a **'trapped'** mechanism where amounts not used for loss absorption in a particular period instead accumulate in a separate ledger and are still available for loss absorption in future periods

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RTS: Full model approach Articles 3 to 6
Methodology for the calculation of EV of SES of future periods

- Art. 3 (Determining payments on the securitised exposures) builds on the **asset model under the existing methodology for the determination of the weighted average maturity** of the contractual payments due under the tranche (EBA/GL/2020/04), thus providing consistency within the regulatory framework. It also adds provisions on modelling defaults and expected losses, which were not in the EBA guidelines as they excluded future defaults.

Steps:

1. In the case of variable SES, **calculating the expected amount to be committed by the originator to cover for future losses** until the end of the expected maturity of the transaction

2. **Estimate the expected losses of each of the future periods** but not the unexpected losses, as the synthetic excess spread is expected to cover the former and not the latter

3. **SES calculated for each of the future periods should be compared with the expected losses of each period**, **either under a trapped or UIOLI mechanisms,** in order **to determine the relevant losses expected to be covered by the SES for each period** under a **front-loaded, an evenly-loaded and a back-loaded loss distribution scenario (loss absorbing capacity of trapped or UIOLI mechanisms varies depending on the loss distribution until the expected maturity)**

4. The **exposure value of SES of future periods in each scenario should be the sum of the losses expected to be covered** by the synthetic excess spread in these future periods

5. The **exposure value of SES of future periods at the calculation date should be the arithmetic average** of the exposure value of SES calculated **under each of the three scenarios**

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RTS: Simplified model approach Article 7
Methodology for the calculation of EV of SES of future periods

- The exposure value of SES of future periods shall be the contractual amount of the SES designated for the next period multiplied by the remaining WAL of the portfolio and by a scalar:

$$\text{Exposure value of SES for future periods} = (\text{SES}_{t+1} * \text{WAL}_t) * \text{Scalar}$$

- Steps:

1. In the case of variable SES, calculating the expected amount to be committed for the next period (using Article 3, which is part of the full model approach, for the next period only)

2. Calculating the remaining WAL (using Article 3, which is part of the full model approach)

3. Scalar shall be equal to 0.8 for UIOLI mechanisms and to 1 for any other mechanism

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Questions for consultation

Q1. Do respondents find the provisions clear enough or would any additional clarification be needed on any aspect?

Q2. Do you agree with the possibility of choosing between the full and the simplified model approaches in a consistent manner?

Q3. Instead, would you favour that the RTS consider only one method (i.e. the full model approach or the simplified model approach) for the calculation of the exposure value of the synthetic excess spread of the future periods?

Q4. Do you agree with the specifications of the asset model made in Article 3?

Q5. Do you agree with the specifications for the determination of the relevant losses made in Article 5?

Q6. Do you agree with the calculation of the exposure value of synthetic excess spread for future periods made in Article 6?

Q7. Shall the average of the scenarios be made in a different way for UIOLI and trapped mechanisms (e.g. back-loaded and evenly-loaded only for UIOLI mechanisms, and front-loaded and evenly-loaded for trapped mechanisms)?

Q8. Do you agree with the specification of the simplified model approach made in Article 7?

Q9. Do you consider that the formula can be further simplified (e.g. by using the maturity of the credit protection multiplied by a conservative scalar instead of WAL)?

Q10. Do you agree with the scalar assigned for UIOLI mechanisms? If not, please provide empirical evidence that justifies a different scalar based on the different loss absorbing capacity of UIOLI vs trapped mechanisms.

Q11. Regarding the current supervisory practices on SES, described in paragraph 9 of the background section, the question is whether these practices could be adapted while keeping them aligned with the amended regulation, and the relative impact they would imply in comparison with the approaches included in the draft RTS. One way to try to further adapt the current supervisory practices on UIOLI SES to the provisions of the amended regulation could be by taking into account the part that is expected to cover for losses in the next period instead of the part that it is not, including at issuance of the transaction, keeping the rolling-window approach.

Would you favour that approach? If so, how do you think that this rolling-window approach for calculating UIOLI SES will affect the efficiency and viability of synthetic transactions in comparison with the current supervisory practices? Please justify your response with specific illustrative examples or data.

Q12. Do you agree with the treatment of the ex-post SES of future periods in the RTS? If not, please provide rationale and data supporting your views

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Next steps

Date	Milestone
9 August 2022	Publication Consultation Paper
14 October 2022	Closure Consultation Period
	Review Comments in response to the Consultation Paper and preparation final revised draft RTS
2022 Q4/ 2023 Q1	Approval process final revised draft RTS
	Submission revised draft RTS to the Commission

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Q&A

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