CP Draft Regulatory Technical Standards on the conditions to calculate K$_{IRB}$ in accordance with the purchased receivables approach

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Mandate

CRR amendment. Article 255(9)

The EBA shall develop draft regulatory technical standards to <u>further specify the conditions to allow institutions to calculate K_{IRB}</u> for the pools of underlying exposures in accordance with paragraph 4, <u>in particular</u> with regard to:

(a) internal credit policy and models for calculating K_{IRB} for securitisations;

(b) use of different risk factors relating to the pool of underlying exposures and, where sufficient accurate or reliable data on that pool are not available, of proxy data to estimate PD and LGD; and

(c) due diligence requirements to monitor the actions and policies of sellers of receivables or other originators

The optionality of Article 255(4)

CRR amendment Art 255(4)

- Institutions **may** calculate K_{IRB} in relation to the underlying exposures of the securitisation in accordance with the provisions set out in Chapter 3 for the calculation of capital requirements for purchased receivables.

- For these purposes, **retail exposures shall be treated as purchased retail receivables and non-retail exposures as purchased corporate receivables**.
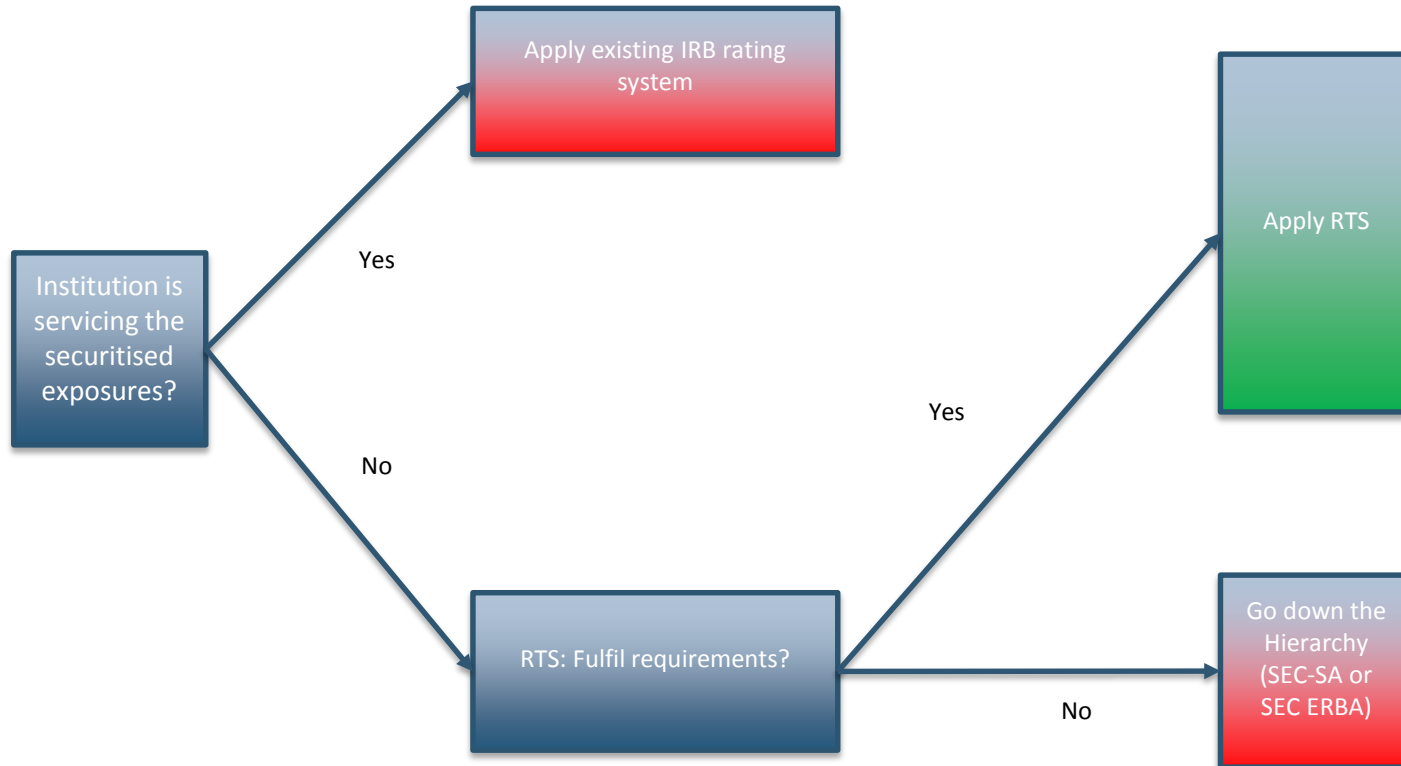
Draft RTS Recital 2

Institutions subject to **limited control and to limited access to information and data on the securitised exposures,** in order to use the SEC-IRBA approach **will effectively need to calculate K_{IRB} in accordance with Article 255(4)** of that Regulation, **which occurs in all cases where** the title to the securitised exposures is acquired by the Securitisation Special Purpose Entity (SSPE) and **the institution is not servicing all of those exposures.**

  - i.e. where institutions are either:
    - investors in securitisation positions,
    - or sponsors or originators retaining securitisation positions in a securitisation transaction and not servicing all of the underlying exposures of such a transaction

Background, paragraph 26:

Competent Authorities should expect modelling standards and compliance with requirements that are aligned with the proposed RTS from any institution calculating capital in relation to securitised exposures that the institution does not service

Scope of use of the RTS

Institution is servicing the securitised exposures?

Yes → Apply existing IRB rating system

No → RTS: Fulfil requirements?

Yes → Apply RTS

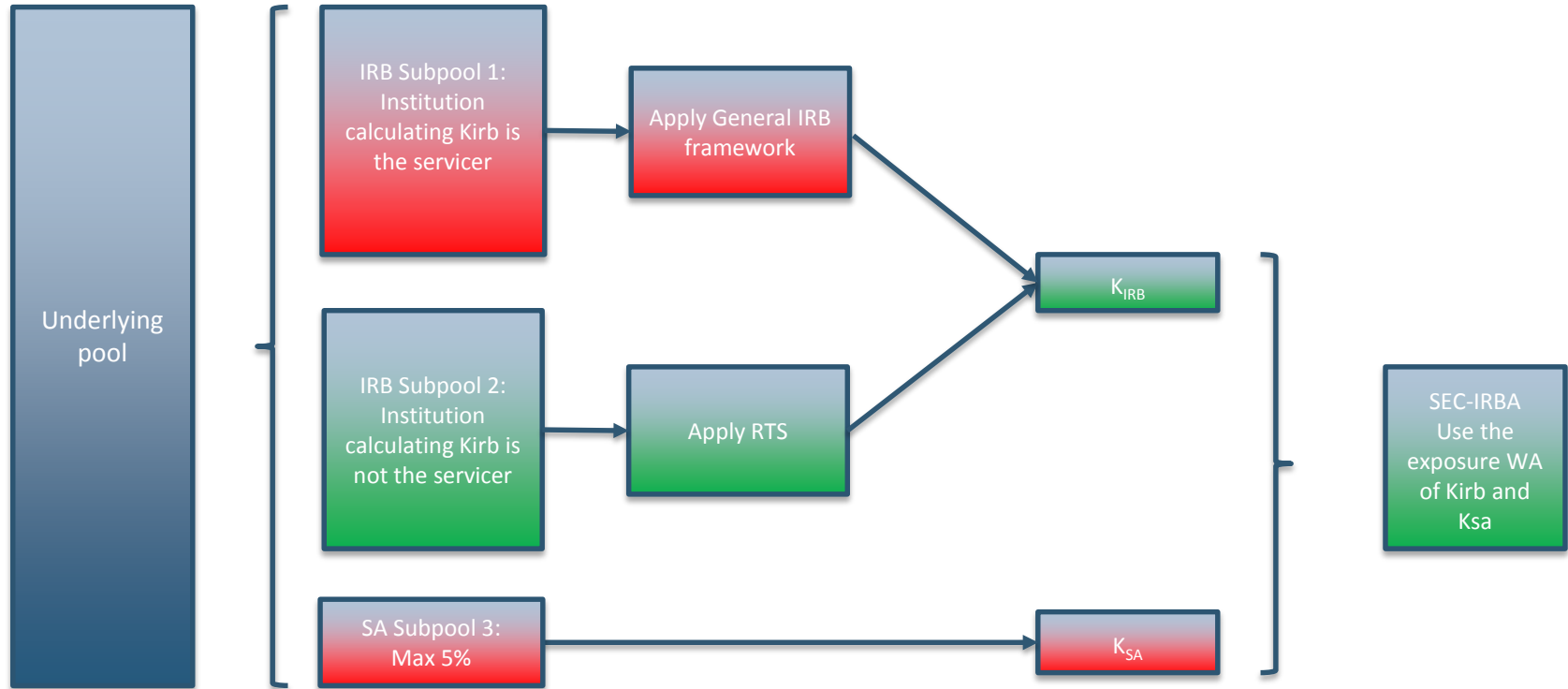No → Go down the Hierarchy (SEC-SA or SEC ERBA)

Scope of application. Flexibility: Recital 15

- Not precluding institutions calculating K_{IRB} in accordance with Article 255(4) from splitting the securitised exposures in sub-pools in order to calculate K_{IRB} differently for each one, as long as each sub-pool meets the corresponding provisions set out in the CRR and in the draft RTS, for instance:
  - exposures serviced by the institution calculating K_{IRB},
  - exposures not serviced by the institution calculating K_{IRB}
    - using the retail risk quantification standards or
    - using the corporate risk quantification standards

- In accordance with Article 258 CRR, the conditions for the use of SEC-IRBA would be met even if a maximum of 5% of the underlying exposure amount does not meet the provisions for the calculation of K_{IRB} in accordance with this Regulation, in which case the K_{SA} of those exposures shall be taken into account in accordance with Article 259(7) of CRR

Scope of application. Example

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Underlying
pool
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IRB Subpool 1: Institution calculating Kirb is the servicer → Apply General IRB framework

IRB Subpool 2: Institution calculating Kirb is not the servicer → Apply RTS

Apply General IRB framework and Apply RTS → K_{IRB}

SA Subpool 3: Max 5% → K_{SA}

K_{IRB} and K_{SA} → SEC-IRBA Use the exposure WA of Kirb and Ksa

Background: Overview of the PuRa in the CRR Requirements

- Operational and due diligence requirements **Art 184 CRR:**

  - aim to ensure that, when estimating risk parameters for purchased receivables,

    o the purchasing institution exercises a sufficient minimum level of control over those receivables on an ongoing basis,

    o has ongoing access to data and information related to the riskiness of the receivables, including from the seller and servicer of the receivables,

    o and takes into account on an ongoing basis the seller's and servicer's characteristics and conduct that may affect the riskiness of the receivables.

- Additionally, the requirement for the retail treatment at **Art 154 (5)** (Purchased from unrelated sellers, arm's length basis, claim on proceeds, portfolio diversified):

  - limits the application of the less burdensome retail risk quantification standards only to plain vanilla portfolios of purchased receivables

- These requirements are to be met in order to ensure a sufficiently prudent and accurate application of the IRB Approach on the purchased receivables

Background: Overview of the PuRa in the CRR Facilitations

General: Data used for estimation Art 179 (1)(e) CRR:

'for purchased receivables the <u>estimates shall reflect all relevant information available to the purchasing institution regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing institution, or by external sources</u>. The purchasing institution shall evaluate any data relied upon which is provided by the seller;'

Corporate purchased receivables:

- Estimate Expected Loss Art 160 (2) and 180 (1)(b) CRR

- LGD 45% / 100% for senior / subordinated receivables. Advanced IRB banks may use its own LGD estimation Art 161 (1)(e)(f) and (2)

- Estimate PD or LGD through EL and the other risk parameter Art 180(1)(c)

- Use retail risk quantification standards (estimate risk parameters at pool level) subject to certain requirements Art 153(6)

- Maturity calculation Art 162(2)(e): Limited to a specific case, use the exposure weighted average maturity

Retail purchased receivables: No additional facilitations (EL estimation and the estimation of PD or LGD through EL and the other risk parameter already are in the retail risk quantification standards)

Background: Overview of the PuRa in the CRR Facilitations. Corporate purchased receivables

Use retail risk quantification standards (estimate risk parameters at pool level i.e. top down approach) subject to certain requirements Art 153(6):

- Comply in addition with the conditions set out in Article 154(5) (**Additional requirement for retail purchased receivables**):

- and where it would be **unduly burdensome** for an institution to use the risk quantification standards for corporate exposures

If so, PD, LGD and EL parameters **may be estimated at pool level**, provided that the purchased receivables have been grouped into sufficiently homogenous pools allowing the institution to obtain accurate and consistent estimates of those parameters For purchased receivables **the grouping shall reflect the seller's underwriting practices and the heterogeneity of its customers** Art 170 (3) (c)

Draft RTS on the conditions to calculate K_{IRB} in accordance with the PuRa

Recital 2

All provisions relating to the use of the Internal Ratings Based Approach (IRB Approach) for exposures other than purchased receivables, including any technical standards and guidelines relating to them, also **apply**, in principle, to the calculation of K_{IRB}.

Recital 5

Provisions of CRR relating to purchased receivables contain **language** relating to that context and not to the context of securitisation transactions, **some of the terminology for purchased receivables should be understood in a manner consistent with the context of securitisation** transactions and this Regulation should clarify these aspects

Recital 6

The **application of some of those rules in the context of securitisation is not appropriate**, either because such rules are not relevant, or because they do not lead to prudent outcomes or because they would be too burdensome for institutions in the context of securitisation. For all such cases, therefore, **this Regulation should specify alternative rules that are appropriate in the context of securitisatio**n

RTS on K_{IRB} under PuRa

Draft RTS: Models for calculating K_{IRB} . Articles 2 and 3

Prior approval and prior experience

- The range of application only includes securitised exposures that are not serviced by the institution (see Recital 1) Rationale: A rating system different than the one used for the exposures that the institution services (balance sheet rating systems) is required. To cater for:
    - The different risk factors (including the underwriting standards and customer heterogeneity of the seller) and different overall management of the exposures;
    - Preserving the homogeneity of the data used for calibration (avoid the pollution of internal data on own originated/serviced exposures with external data and proxy data);

- Approval (of the rating system) the first time. Subsequent changes, are governed by the general rules including the RTS on model changes;

- On such approval no three-year prior use required if the institution already is IRB at the level of the same exposure class

Draft RTS: Credit policy and due diligence
Art 4 Draft RTS instead of Article 184 of CRR

Art 184 CRR

Institutions shall ensure:

- Effective ownership and control on cash remittances

- Monitor both the quality of the receivables and the financial condition of seller and servicer

- Assess characteristics of the receivables

- Ensure that detailed reports from the servicer are received

- Systems and procedures for monitoring concentration and detecting deteriorations in the seller's financial condition and purchased receivables

- Policies and procedures governing the control of the receivables

- Internal process for assessing compliance with internal policies and procedures

Art 4 RTS

Institutions calculating K_{IRB} shall ensure, on their own or through a party to the securitisation acting for and in the interest of the investors in the securitization:

- The SSPE has effective ownership and control of all cash remittances from the securitised exposures

- Ensure that detailed reports from the originator or the servicer are received

- Monitors both the quality of the securitised exposures and the financial condition of the originator and servicer

- Systems and procedures for monitoring concentration and detecting deteriorations in the originator's financial condition and the securitised exposures

- policies and procedures governing the control of securitised exposures,

- Internal process for assessing compliance with internal policies and procedures including regular audits of all critical phases of the securitisation, …

Draft RTS on K$_{IRB}$ in accordance with the PuRa
General conditions for risk differentiation. Art 5

When assigning exposures to grades or pools, institutions shall consider the <u>originator's underwriting standards</u> and the <u>servicer's recovery practices and servicing standards</u> as risk drivers, unless they use different calibration segments for different originators and different servicers in quantifying the risk parameters associated with those grades or pools

➢ Complementary of Art 170 (3) (c) CRR: For purchased receivables <u>the grouping shall reflect the seller's underwriting practices and the heterogeneity of its customers</u>

Draft RTS: Eligibility of the retail treatment of <u>non-retail</u> securitised exposures. Art 6 Draft RTS instead of Art 153(6)CRR

Art 153(6) CRR

- Comply in addition with the conditions set out in Article 154(5) (**Additional requirement for retail purchased receivables**):

    o Purchased from unrelated third parties

    o Generated on an arm's length basis

    o Claim on all proceeds from the receivables, at least on a pro-rata basis

    o Portfolio sufficiently diversified

- and where it would be **unduly burdensome** for an institution to use the risk quantification standards for corporate exposures

Art 6 RTS

- the SSPE shall have purchased the securitised exposures <u>from unrelated third party originators</u> to the institution calculating K_{IRB}

- generated on an <u>arm's-length basis between the originator and the obligor</u>

- <u>the SSPE shall have a claim</u> on all proceeds from the securitised exposures or a pro-rata interest in the proceeds;

- the <u>pool of securitised exposures</u> shall be sufficiently diversified

- and it would be **unduly burdensome** for an institution to use the risk quantification standards for corporate exposures **(considerations are added)**

Draft RTS: Eligibility of the retail treatment of non-retail securitised exposures
Art 6 Draft RTS instead of Article 153(6) and 154 (5) CRR

Assessment on **unduly burdensome ,**on the basis of the following considerations in a holistic manner:

(a) the cost to the institution calculating K_{IRB} of using the corporate purchased receivables approach is materially affecting the decision to proceed with the investment when compared to the use of the retail risk quantification standards,

(b) the control and ease of access to relevant data for the institution;

(c) the operational capability of the institution to integrate any external or proxy data into existing risk and reporting systems;

(d) the pool of securitised exposures is sufficiently granular so as to support the above considerations,

- where the number of underlying exposures of the securitisation to which the retail treatment is to be applied exceeds 500
- and the aggregate exposure value of all such exposures to a single obligor in the pool do not exceed [2] % of the aggregate outstanding exposure values of the pool of securitised exposures.

(e) the size and frequency of securitisation exposures within the institution is not considered to be a material risk to the institution.

Draft RTS: Eligibility of the retail treatment of <u>retail</u> securitised exposures. Art 7 Draft RTS instead of Article 154 (5) CRR

Art 154(5) CRR

- Purchased from unrelated third parties

- Generated on an arm's length basis

- Claim on all proceeds from the receivables, at least on a pro-rata basis

- Portfolio sufficiently diversified

Art 7 RTS

- Generated on an <u>arm's-length basis between the originator and the obligor</u>

- <u>The SSPE shall have a claim </u>on all proceeds from the securitised exposures or a pro-rata interest in the proceeds;

- The <u>pool of securitised exposures </u>shall be sufficiently diversified

If first point Art 154(5) were applied (meaning the SSPE purchased from unrelated third parties), an originator that does not service the exposures underlying the securitisation would be precluded from treating under retail risk quantification standards the securitised exposures that itself has originated and classified as retail exposures

Draft RTS: Calculation of risk-weighted exposure amounts for credit risk of securitised exposures. Art 8

- retail securitised exposures that meet the requirements set out in Article 7: risk-weighted exposure amounts for credit risk in accordance with Articles 154 CRR (retail IRB formula) and, where applicable, Article 156 (b) CRR (residual value).

- non-retail securitised exposures: irrespective of whether the conditions in accordance with Article 6 for applying retail risk quantification standards are met or not in respect of such exposures, calculate risk-weighted exposure amounts for credit risk, in accordance with Article 153 (corporate formula) and, where applicable, Article 156 (b) CRR (residual value).

Draft RTS on K$_{IRB}$ in accordance with the PuRa Requirements on Data. Articles 9 and 10

- Article 9.2 Institutions shall regard <u>data related to the securitised exposures as the primary source of information for estimating loss characteristics</u>

- Recital 13 <u>Proxy data </u>in the context of this Regulation should be understood to refer to any data that are of a lesser quality than would be ideal, which in the case of securitisation is <u>any data not directly referring to the securitised exposures</u>

- Article 10 <u>Proxy data can be internal, external or pooled data</u>

- Article 9.1 Representativeness of the data shall be assessed in relation to the securitised exposures (<u>Representativeness</u>: follow GL on PD estimation, LGD estimation and the treatment of defaulted exposures)

- Article 10 <u>Margin of conservatism </u>The requirements of Article 179(1)(f) of CRR on conservatism when institutions make use of proxy data in the course of the estimation, shall apply also when they use proxy data for the purposes of model development, calibration of risk parameters and application of the internal model for calculating KIRB (<u>MoC</u> also follow GL on PD estimation, LGD estimation and the treatment of defaulted exposures)

Draft RTS on K_{IRB} in accordance with the PuRa
Use of data that is not itself consistent with the definition of default in accordance with Article 178(1) CRR. Art 11

In order to apply the purchased receivables approach to securitised exposures, the RTS transposes the Section 6 of the EBA Guidelines 2016/07 on the application of the definition of default in external data, making it mandatory for external data and proxy data under the scope of this Regulation.

- Where the definition of default used in the external data and the proxy data is different from the definition used by the institution calculating K_{IRB} in its rating system.
    - Adjustments in the external data and proxy data
    - If adjustments not possible, MoC in accordance with Art 179(1)(f)

Draft RTS on K_{IRB} in accordance with the PuRa Questions:

Models for calculating K_{IRB} . Articles 2 and 3

- Q1: Do you agree with the requirement that a rating system shall be exclusively used for securitised exposures that the institution does not service, i.e. for the exposures that are in the scope of these draft RTS?

- Q2: Should an exception be introduced for certain corporate exposures (e.g. large corporate exposures that the institution may rate using the corporate rating system it uses to rate corporate clients)? Should such exception be limited to the estimation of PD? If yes, what alternative would you propose for LGD estimation?

Credit policy and due diligence. Art 4

- Q3: Do you agree with the fact that, unlike traditional securitisations, synthetic securitisations cannot meet the general conditions set out in this article and in particular the requirements on indirect control and ownership of the securitised exposures by the institution calculating K_{IRB}?

Requirement s on Data. Articles 9 and 10

- Q4: Do you consider that a more detailed definition of proxy data is necessary? If yes, please provide a suitable definition

General

- Q5: Do you consider that the provisions set out in the draft RTS are workable if applied to securitisations of non-performing exposures?

- Q6: Do you have any other comments on the draft RTS?

Thank you!