Single Rulebook Q&A

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Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit Risk – Non performing exposures / loan origination
Article	36
Paragraph	1
Subparagraph	m
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	Not applicable
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Disclose name of institution / entity	Yes
Name of institution / submitter	Association for Financial Markets in Europe (AFME)
Country of incorporation / residence	United Kingdom
Type of submitter	Industry association
Subject matter	Underlying exposures of securitisations and calculation of the applicable amount of insufficient coverage for NPE for the purpose of calculating deductions from CET1 items
Question	Are underlying exposures of a traditional or synthetic securitisation, for which the originator has either: i) achieved Significant Risk Transfer (SRT) as per Article 244(1)(a) or Article 245(1)(a); or ii) following the full deduction approach as per Article 244(1)(b) or Article 245(1)(b) in or out of scope of the minimum loss coverage requirement for non-performing exposures (see Article 36(1)(m) and Article 47a CRR)?
Background on the	There is no clear statement in the CRR, which excludes underlying

question	securitised exposures from the scope of the minimum loss coverage requirement for non-performing exposures of either a traditional or synthetic securitisation, for which SRT is met or where a full deduction approach is applied by the originator. The scope of Non-Performing Exposures (NPEs) to which apply the minimum loss coverage requirement introduced by Regulation (EU) 2019/630 (“The backstop regulation”), amending the Regulation 575/2013, is specified by Article 47a CRR. For the purposes of Article 36(1)(m), Article 47a CRR includes all exposures (excluding those in the trading book) which are: (a) a debt instrument, including a debt security, a loan, an advance and a demand deposit; (b) a loan commitment given, a financial guarantee given or any other commitment given, irrespective of whether it is revocable or irrevocable, with the exception of undrawn credit facilities that may be cancelled unconditionally at any time and without notice, or that effectively provide for automatic cancellation due to deterioration in the borrower's creditworthiness. In Article 47a(3) CRR there are listed all the conditions for the above exposures to be classified as non-performing, among all the default in accordance with Article 178 of the CRR (point (a)), and the impairment according to the applicable accounting framework (point (b)). According to the above, there is no mention in these CRR Articles about the inclusion or exclusion of securitisation positions from the scope of the backstop regulation, leaving it unclear. Considering Article 47a(1) CRR, it can be argued that only the case of “debt instrument” (point a) can be potentially interpreted as inclusive also of securitisation positions. Nevertheless, according to Article 4(1)(61) CRR, securitisation has its own specific definition and in Article 4(1)(62) a “securitisation position' is simply defined as an exposure to a securitisation. It is also worth noting that in the bulk of the CRR, requirements for debt instruments are kept separate from those regarding securitisation positions, which are explicitly mentioned. Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, defines in Article 2 “securitisation” as in Article 4(61) CRR, by adding only an exclusion for those exposures defined in Article 147(8) CRR. To the extent that in the current regulatory framework there is no reference to securitisation positions as debt securities, it seems very difficult to match the definition of securitisation with one of the two provided in Article 47a for which minimum loss coverage applies. Moreover, compared to a common debt instrument (for example a corporate bond), securitisation positions are generally designed to be loss absorbing and to sustain losses, that are statistically expected since the beginning, throughout the life of the securitisation. This phenomenon is clearly driven by the underlying securitised pool of assets and its lifetime performance. The terms and conditions of the notes provide for the priority of payments of investors in normal and distressed scenarios. Therefore, principal losses on a securitisation tranche (for example a junior one) may occur, but without triggering a regulatory classification of default, which does not apply in this context. This is simply driven by the portfolio performances that can affect

	positively or negatively the overall return on the investment. Consequently, securitisation positions do not have credit events similar to, for example, corporate exposures and therefore, the application of the minimum loss coverage seems to be not appropriate. Additionally, with respect to traditional securitisations, regardless of having obtained accounting derecognition of the underlying portfolio, the originator excludes the RWAs and Expected Losses of the underlying portfolio, when either SRT is met or all retained securitisation positions are subject to a full deduction. However, a statement to exclude the relevant securitised exposures from the minimum loss coverage requirement is missing, which would be coherent and aligned with the exclusion of RWAs and Expected Losses. A similar analogy applies in the context of synthetic securitisations: Originators that have transferred significant credit risk associated with the underlying exposures of a synthetic securitisation, or following the full deduction approach, are allowed to calculate risk-weighted exposure amounts in accordance with Article 251. Per Article 251, the originator shall calculate risk-weighted exposure amounts with respect to all retained tranches in the securitisation by applying the methods specified by Article 254, and the securitisation positions through which the risk is transferred by the originator by applying credit risk mitigation technique in accordance with Article 249. Article 251 clearly states that the "Expected Loss amounts with respect to the underlying exposures under Chapter 3 […] shall be zero". Article 159 also states that "Expected Loss amounts for securitised exposures and general and specific credit risk adjustments related to those exposures shall not be included in that calculation". In conclusion, a clear reference to the minimum loss coverage requirement is also missing in the context of synthetic securitisations, but again the exclusion from this requirement would be coherent and aligned with the exclusion of Expected Losses.
Final answer	Regulation (EU) No 2019/630 amended Regulation (EU) No 575/2013 (CRR) by introducing an obligation that credit institutions maintain a minimum coverage requirement on non-performing exposures that are not sufficiently covered by specific credit risk adjustments or other adjustments for the purposes of determining the risk-weighted exposures amounts and, where relevant, expected loss amounts for credit risk. In accordance with Article 47a(1)(a) CRR, for the purposes of Article 36(1)(m) of that Regulation, exposures shall include any debt instrument, including a debt security, a loan, an advance and a demand deposit, provided that such debt instrument is not included in the trading book of the institution. This general requirement effectively ensures the uniform application of the minimum coverage requirement for non-performing exposures by all institutions in the Union. In accordance with Article 244(1) CRR, the originator institution of a traditional securitisation may exclude underlying exposures from its calculation of risk-weighted exposure amounts and, where relevant, expected

	loss amounts when, in accordance with point (a) of that paragraph, it has transferred significant credit risk associated with the underlying exposures to third parties or when, in accordance with point (b) of that paragraph, it applies a 1,250 % risk weight to all securitisation positions it holds in the securitisation or deducts these securitisation positions from Common Equity Tier 1 (CET1) items in accordance with Article 36(1)(k) CRR. Accordingly, non-performing exposures underlying a traditional securitisation fall outside the scope of Article 47a(1)(a) CRR because they are not subject to Article 36(1)(m) of that Regulation where the securitisation meets the conditions set out in Article 244(1) point (a) or (b). This is because a significant amount of the credit risk associated with those underlying exposures has been either transferred to third parties or fully covered by own funds requirements as the securitisation positions that the originator institution holds are subject to a 1,250 % risk-weight or deducted from CET1 items. The same logic applies to non-performing exposures underlying a synthetic securitisation where the securitisation meets the conditions set out in Article 245(1) point (a) or (b) of the CRR. The above is without prejudice to the competent authorities' supervisory powers in accordance with Directive 2013/36/EU. In particular, competent authorities may make use of the supervisory powers provided for in Article 104(1)(d) of that Directive, by virtue of which they may require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements where they ascertain, on a case-by-case basis, that the non-performing exposures of an institution have an insufficient provision cover. *The answers clarify provisions already contained in the applicable legislation. They do not extend in any way the rights and obligations deriving from such legislation nor do they introduce any additional requirements for the concerned operators and competent authorities. The answers are merely intended to assist natural or legal persons, including competent authorities and Union institutions and bodies in clarifying the application or implementation of the relevant legal provisions. Only the Court of Justice of the European Union is competent to authoritatively interpret Union law. The views expressed in the internal Commission Decision cannot prejudge the position that the European Commission might take before the Union and national courts.*
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