EBA/CP/2013/45
17.12.2013

Consultation Paper

Draft Guidelines

On Significant Credit Risk Transfer relating to Article 243 and Article 244 of Regulation 575/2013

Consultation Paper on Draft Guidelines on Significant Credit Risk Transfer relating to Article 243 and Article 244 of Regulation 575/2013

Table of contents

1. Responding to this Consultation

the EBA invites comments on all proposals put forward in this paper. and in particular on the specific questions summarised in Section 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA could consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by **17.03.2014**. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Regulation (EU) No 575/2013 ('CRR') sets out the rules for the recognition of significant risk transfer (SRT) for traditional and synthetic securitisation transactions for originator institutions, in Article 243(2) and Article 244(2). In case the SRT requirements have been met, originator institutions of a traditional securitisation may exclude securitised exposures from the calculation of risk-weighted exposure amounts and, as relevant, expected loss amounts, and originator institutions of a synthetic securitisation may calculate the risk-weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with Article 249 of Regulation (EU) 575/2013.

In the same Article 243(2) and Article 244(2), the CRR includes the possibility for competent authorities to decide on a case-by-case basis 'that the significant risk transfer shall not be considered to have been transferred to third parties' because the reduction in risk-weighted exposure amounts achieved by the securitisation transaction is not justified by a commensurate transfer of credit risk to third parties. Furthermore Article 243(4) and Article 244(4) provide the possibility for competent authorities to grant permission to originator institutions to consider significant credit risk as having been transferred, via an alternative manner to Article 243(2) and Article 244(2), where the originator institution is able to demonstrate, that the reduction of own funds requirements which the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties. In addition the institution must meet the additional conditions according to points (a) and (b) of paragraph 4 of Article 243 or 244.

The CRR (Article 243(6) and Article 244(6)) requires competent authorities to keep EBA informed about the specific cases, referred to Article 243(2) and Article 244(2), where the possible reduction in risk-weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties, and the use institutions make of Article 243(4) and Article 244(4). Furthermore it requires that the EBA shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No 1093/2010 issue guidelines. It also requires the EBA to review Member States' implementation of those guidelines and provide advice to the Commission by 31 December 2017 on whether a binding technical standard is required in this area.

Scope and content of the Guidelines on Significant Risk Transfer

The Guidelines have been drafted to provide more guidance on the assessment of SRT according to Article 243 or Article 244 of the CRR and apply to both originator institutions and competent authorities. The guidelines include i) requirements for originator institutions when engaging in securitisation transactions for SRT, ii) requirements for competent authorities to assess transactions that claim SRT using Articles 243(2) or 244(2) and iii) requirements for competent authorities when assessing whether commensurate credit risk has been transferred to third parties in accordance with Articles 243(4) or 244(4). In addition to this, the scope of the Guidelines covers SRT more broadly than the three requirements listed above, where this is considered necessary by the EBA.

Originator institutions should apply the (i) general requirements of the Guidelines for all transactions claiming SRT under Article 243 or 244 of CRR and (ii) the specific requirements of the Guidelines in order to achieve SRT to third parties in accordance with Article 243(4) or 244(4) CRR.

Competent authorities should apply these Guidelines in the following situations:

a. when identifying those securitisation transactions where the credit risk is not considered to have been transferred even though these transactions are meeting either of the conditions under Articles 243(2) or 244(2) of CRR;

b. when assessing an originator institution's compliance with the requirements according to Articles 243(4) and 244(4) of CRR;

c. when collecting data to be provided to the EBA in accordance with Articles 243(6) and 244(6) of CRR.

The EBA believes that all EU Member States should assess and treat significant credit risk transfer in the same way in view of the establishment of the single rule book, and believes these Guidelines will encourage this objective.

3. Background and rationale

The Basel II capital framework recognises that credit risk transfer techniques can significantly reduce credit risk to which institutions are exposed and recognises that the credit risk transfer can be an effective risk management tool. The framework establishes that where credit risk transfers are direct, explicit, irrevocable and unconditional, and supervisors are satisfied that banks fulfil certain minimum operational conditions relating to risk management processes, banks may take account of such credit risk transfer in calculating own funds requirements.

Nevertheless, the Basel Committee of Banking Supervisors (BCBS) notes[1] that there exists potential for capital arbitrage within the credit risk mitigation framework, including use of credit risk mitigation for securitisation exposures, particularly when (i) there is a delay in recognising the cost of protection in earnings while (ii) the bank receives an immediate regulatory capital benefit in the form of a lower risk weight on an exposure on which it is nominally transferring risk. In such instances, there may be no meaningful transfer of risk.

While the arbitrage opportunities exist more generally under the credit risk mitigation framework, the arbitrage opportunities are more likely to occur when credit risk transfer techniques are used for securitisation transactions, where the difference in the risk weight before and after transferring credit risk can be very large.

In the EU, the CRR sets out the rules for the recognition of SRT for traditional and synthetic securitisation transactions for originator institutions in Article 243 and in Article 244. In case the SRT requirements have been met, originator institutions of a traditional securitisation may exclude securitised exposures from the calculation of risk-weighted exposure amounts and, as relevant, expected loss amounts, and originator institutions of a synthetic securitisation may calculate the risk-

[1] High-cost Credit Protection (HCCP) consultation paper (http://www.bis.org/publ/bcbs245.pdf)

weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with Article 249 of Regulation (EU) 575/2013.

Importance of assessment of Significant Credit Risk Transfer

When an originator institution undertakes a securitisation, if it has transferred a significant portion of the risk of its exposures to a third party, it is permitted to reduce its own funds requirements accordingly, i.e. the originator institution has achieved SRT. In practice, originator institutions can technically satisfy the rules for the recognition of SRT, without actually achieving commensurate risk transfer, which necessitates closer analysis by competent authorities.

It is important that competent authorities and originator institutions consider a range of factors when assessing whether commensurate credit risk has been transferred in a given transaction to an independent third party.

Not all factors referred to in this guidance will be relevant in all transactions, but equally it should not be considered an exhaustive list, and there may be other issues which competent authorities and/or originator institutions could consider in determining if commensurate credit risk transfer has been achieved.

Additional CRR requirements related to the application of the securitisation framework

Article 243(5) and Article 244(5) set out conditions that should be met, in addition to the requirements set out in paragraphs 1 to 4 in Article 243 and Article 244 of the CRR, in order to apply the securitisation framework. For traditional securitisations (Article 243(5)) the CRR specifically requires the following conditions to be met:

(a) the securitisation documentation reflects the economic substance of the transaction;

(b) the securitised exposures are put beyond the reach of the originator institution and its creditors, including in bankruptcy and receivership. This shall be supported by the opinion of qualified legal counsel;

(c) the securities issued do not represent payment obligations of the originator institution;

(d) the originator institution does not maintain effective or indirect control over the transferred exposures. An originator shall be considered to have maintained effective control over the transferred exposures if it has the right to repurchase from the transferee the previously transferred exposures in order to realise their benefits or if it is obligated to re-assume transferred risk. The originator institution's retention of servicing rights or obligations in respect of the exposures shall not of itself constitute indirect control of the exposures;

(e) the securitisation documentation meets all the following conditions:

- *it does not contain clauses that other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator institution including but not limited to altering the underlying credit exposures or increasing the yield payable to investors in response to a deterioration in the credit quality of the securitised exposures;*
- *it does not contain clauses that increase the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool;*

- *it makes it clear, where applicable, that any purchase or repurchase of securitisation positions by the originator or sponsor beyond its contractual obligations is exceptional and may only be made at arms' lengths conditions;*

(f) where there is a clean-up call option, that option shall also meet the following conditions:

- *it is exercisable at the discretion of the originator institution;*
- *it may only be exercised when 10 % or less of the original value of the exposures securitised remains unamortised;*
- *it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement.*

For synthetic securitisations (Article 244(5)), the following conditions need to be met:

(a) the securitisation documentation reflects the economic substance of the transaction;

(b) the credit protection by which the credit risk is transferred complies with Article 247(2);

(c) the instruments used to transfer credit risk do not contain terms or conditions that:

- *impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;*
- *allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;*
- *other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator institution;*
- *increase the institution's cost of credit protection or the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool;*

(d) an opinion is obtained from qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions;

(e) the securitisation documentation shall make clear, where applicable, that any purchase or repurchase of securitisation positions by the originator or sponsor beyond its contractual obligations may only be made at arms' lengths conditions;

(f) where there is a clean-up call option, that option meets all the following conditions:

- *it is exercisable at the discretion of the originator institution;*
- *it may only be exercised when 10 % or less of the original value of the exposures securitised remains unamortised;*
- *it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement.*

Criteria for credit granting (Article 408)

Furthermore, in order to apply the securitisation framework originator institutions shall apply the same sound and well-defined criteria for credit-granting in accordance with the requirements of Article 79 of Directive 2013/36/EU to exposures to be securitised as they apply to exposures to be held in their own non-trading book. To this end the same processes for approving and, where relevant, amending, renewing and re-financing credits shall be applied by the originator and sponsor institutions.

Where the requirements referred to in the first subparagraph of Article 408 are not met, Article 245(1) shall not be applied by an originator institution and that originator institution shall not be allowed to exclude the securitised exposures from the calculation of its capital requirements under the CRR.

4. Draft EBA Guidelines on Significant Credit Risk Transfer relating to Article 243 and Article 244 of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

Status of these Guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC ('EBA Regulation'). In accordance with Article 16(3) of the EBA Regulation, competent authorities and financial institutions must make every effort to comply with the guidelines.

2. Guidelines set out the European Banking Authority's ('EBA') view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. The EBA therefore expects all competent authorities and institutions to whom guidelines are addressed to comply with these guidelines. Competent authorities to whom guidelines apply should comply by incorporating them into their supervisory practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Table of contents

Title I – Scope of application and general principles

1. Scope of application

1. These Guidelines apply to:

   a. competent authorities;
   b. originator institutions subject to Article 243 and 244 of Regulation (EU) 575/2013.

2. Originator institutions should apply the (i) general requirements of the Guidelines for all transactions claiming SRT under Article 243 or 244 of Regulation (EU) No 575/2013 and (ii) the specific requirements of the Guidelines in order to achieve SRT to third parties in accordance with Article 243(4) or 244(4) of Regulation (EU) No 575/2013.

3. Competent authorities should apply these Guidelines in the following situations:

   a. when identifying those securitisation transactions where the credit risk is not considered to have been transferred even though these transactions are meeting either of the conditions under Articles 243(2) or 244(2) of Regulation (EU) No 575/2013;

   b. when assessing an originator institution's compliance with the requirements according to Articles 243(4) and 244(4) of Regulation (EU) No 575/2013;

   c. when collecting data to be provided to the EBA in accordance with Articles 243(6) and 244(6) of Regulation (EU) No 575/2013.

2. General principles

1. Fulfilment of the conditions laid down in points (a) or (b) of either of the Articles 243(2) or 244(2) of Regulation (EU) No 575/2013 entitles the originator institution of a traditional securitisation to exclude the respective securitised exposures from the calculation of risk-weighted exposure amounts and, as relevant, expected loss amounts, and entitles the originator institution of a synthetic securitisation to calculate the risk-weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with Article 249 of Regulation (EU) No 575/2013 unless the competent authority decides on case-by-case basis that significant credit risk shall not be considered to have been transferred to third parties or any of the conditions according to Articles 243(5) or 244(5) of Regulation (EU) No 575/2013 are not satisfied with regard to this securitisation.

2. Competent authorities should ensure that procedures exist for the identification of such securitisation transactions which should, notwithstanding compliance with points (a) or (b) of Articles 243(2) or 244(2) of Regulation (EU) No 575/2013, be subject to further review by the competent authority in accordance with Title III of these Guidelines in order to assess whether a commensurate transfer of credit risk to third parties has indeed been achieved by the transaction.

3. The conditions for achieving SRT to third parties should be satisfied on a continuous basis.

4. Originator institutions should assess the reliance placed on external credit assessments in their analyses of transactions claiming SRT and the relationship between such external credit assessments and internal credit assessments.

Title II – Criteria for competent authorities in case of application of Article 243(2) or Article 244(2) of Regulation (EU) No 575/2013

3. Criteria to determine when competent authorities should conduct a comprehensive review of SRT in case of application of Article 243(2) or Article 244(2) of Regulation (EU) 575/2013

1. With regard to those securitisation transactions meeting the conditions for achieving SRT in accordance with points (a) or (b) of Article 243(2) or Article 244(2) of Regulation (EU) No 575/2013, competent authorities should conduct a comprehensive review of SRT in accordance with paragraphs 4 to 10 of these Guidelines, where any of the following circumstances (non-exhaustive list) applies:

   a. Particular information indicates that the thickness of a securitisation's tranches which are used as relevant tranches to demonstrate SRT under Articles 243(2) or 244(2) of the Regulation (EU) No 575/2013 may not be sufficient to assume a commensurate SRT to third parties with regard to (i) the special credit risk profile and (ii) the corresponding risk-weighted exposure amounts of the securitised exposures of this securitisation.

b. Doubts regarding the appropriateness of a particular credit assessment of an ECAI.

Explanatory Box

For example, such doubts may arise due to a lack of experience or track record of an ECAI or due to evident methodical problems of an ECAI with regard to assigning credit assessments to securitisation positions of a certain asset class.

c. Losses incurred on the securitised exposures in previous periods or other information indicate that an institution's reasoned estimate of the expected loss on the securitised exposures according to point (b) of Articles 243(2) or 244(2) of Regulation (EU) No 575/2013 may be too low for considering significant credit risk as having been transferred to third parties.

d. Losses incurred on the securitised exposures in previous periods or other information indicate that the margin by which the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1 250% risk weight exceed the reasoned estimate of the expected loss may be too low for considering significant credit risk as having been transferred to third parties.

e. The high costs incurred by the originator institution to transfer credit risk to third parties through a particular securitisation indicate that the SRT formally achieved under points (a) or (b) of either of the Articles 243(2) or 244(2) of Regulation (EU) No 575/2013 may actually be undermined by the high cost of this transfer of credit risk.

f. An originator institution intends to demonstrate the SRT to third parties in accordance with points (a) or (b) of either of the Articles 243(2) or 244(2) of Regulation (EU) No 575/2013 in the absence of an ECAI rating for the relevant tranches.

g. Securitisations transactions of trading book portfolios.

Title III - Requirements for competent authorities in case of application of Article 243 (4) or Article 244 (4) of Regulation (EU) No 575/2013 and in case of application of Article 243(2) or Article 244(2) of Regulation (EU) No 575/2013 where any of the circumstances in accordance with Title II applies

4. Assessment of the significance of the credit risk transfer

1. Competent authorities should assess the documentation and evidence provided by the originator institution relating to the securitisation in order to determine whether commensurate credit risk has been transferred to third parties and require additional information, where this is needed to conduct the assessment. In particular competent authorities should pay particular attention to amongst others, the following factors, as applicable:

   a. the risk-weighted exposure amounts and, as relevant, expected loss amounts calculated for the securitised exposures before securitisation and the corresponding amounts for the tranches transferred and retained by the originator institution after securitisation;

   b. with respect to originator institutions demonstrating SRT in accordance with Articles 243(4) or 244(4) of Regulation (EU) No 575/2013, the methods used to demonstrate that the credit risk which has been transferred is commensurate with the possible reduction in own funds requirements.

Explanatory Box

For example competent authorities could look at economic capital models or stress testing of the underlying asset pool when assessing the methods.

c. where the originator institution has used internal models to demonstrate that significant credit risk has been transferred, whether these models are appropriately robust and where external models have been used whether these models have been integrated into the originator institution's regular processes, and whether the originator institution has an appropriate understanding of how the model operates and its underlying assumptions;

d. where the originator institution has used specific stress assumptions on the underlying asset pool, the suitability of such assumptions and how these assumptions and resultant projected losses compare with those used for supervisory stress testing or with other empirical sources of such data, such as the rating agencies.

2. Competent authorities should consider whether the originator institution has sufficient knowledge of the underlying assets in order to be able to conduct an appropriate credit risk transfer analysis and should also consider whether there is idiosyncratic risk in the portfolio which is not captured by the originator institution's credit risk assessment or capital calculations. Idiosyncratic risk should be captured through more conservative assumptions than a standard "base case" scenario. This conservatism should seek to capture idiosyncratic risk which may correspond with a "stress case" scenario if applicable.

3. In the case where the originator institution is relying on the supervisory formula to determine its post-securitisation own funds requirements, competent authorities should consider how sensitive the own funds requirements on the originator institution's retained securitisation positions are to changes in the underlying IRB parameters. If the capital requirements on the retained securitisation positions are highly sensitive to small changes in these parameters, it is less likely that commensurate credit risk has been transferred.

5. Assessment of structural features

1. Competent authorities should assess if there are structural features in a transaction which might undermine the claimed SRT to third parties, such as features like optional calls which in case of traditional securitisations increase the likelihood that assets will be brought back onto the originator institution's balance sheet or in case of synthetic securitisations increase the likelihood that the credit protection will be terminated before the transaction's maturity.

Explanatory Box

Examples of such features include optional calls, where there is an incentive for the originating institution to call the transaction. These optional calls may be based on time, a price or spread linked strike, or a step up in the cost of protection (this list is not exhaustive). In principle SRT cannot be achieved for a traditional securitisation transaction which includes a time-call option, as the assets have been sold to the SPV.

2. Competent authorities should consider if the originator institution has in the past repurchased transactions to protect investors and if the rules on implicit support as specified in Article 248 of Regulation (EU) No 575/2013 have been followed by the originator institution to ensure that risk has effectively been transferred.

3. Competent authorities should consider whether a transaction contains clean-up or regulatory calls and whether such calls are appropriately limited to exclude concerns about the originator institutions supporting transactions to ensure that risk has effectively been transferred.

4. Where transactions include replenishment periods, competent authorities should consider the eligibility criteria of the assets in the underlying pool and give consideration to the minimum and maximum credit quality of eligible assets, and consider if the assets can be substituted into the structure with the view to protecting investors from losses while increasing credit risk to the originator institution to ensure that risk has effectively been transferred.

5. Competent authorities should consider that transactions do not include any embedded mechanism at origination that is reducing the amount of credit risk transfer by the originator institution to third parties disproportionately over time.

6. Mismatches between credit protection and underlying assets for synthetic securitisations

1. Competent authorities should consider if there are maturity or currency mismatches between the protection provided and the underlying assets. When considering the maturity of the protection, competent authorities should consider whether optional calls or other features might reduce the maturity of the protection in practice, and how this relates to the expected time of defaults on the asset pool.

2. Competent authorities should assess maturity mismatches for transactions where asset pools are able to replenish as originator institutions may substitute in longer maturity assets towards the back-end of the protection period, increasing any maturity mismatch.

3. Competent authorities should assess currency mismatches for transactions where asset pools contain a different currency profile to the liabilities. Where such mismatches occur, prudent haircuts should be applied to the capital relief sought in accordance with the views of the competent authorities. Mitigating instruments, such as currency swaps should be assessed for appropriateness in terms of the balance swapped, the duration of the swap itself, and any contingent triggers.

7. Credit protection issues for synthetic securitisations

1. Where the securitisation is achieved synthetically using a credit derivative or a guarantee, competent authorities should ensure that the credit protection meets all the relevant requirements set forth in Regulation (EU) No 575/2013 and provides sufficient certainty of payment so as not to undermine the credit risk transfer. If the credit protection is funded, the collateral arrangements should be considered including that they meet all the relevant requirements set forth by Regulation (EU) No 575/2013 for funded credit protection. If the credit protection is unfunded, competent authorities should consider whether suitable arrangements are in place to ensure timely payment.

2. Competent authorities should consider the credit events that are covered by the credit protection obtained (e.g. whether it includes standard credit events like bankruptcy, failure to pay or restructuring of loans).

3. Competent authorities should consider whether premia paid to credit protection providers are excessively high to the extent that SRT will be undermined. This could be assessed in a number of ways such as by looking at the premia paid compared to (i) the yield of the asset pool, or (ii) the losses being covered by the protection, or (iii) fair market rates, or (iv) some combination of these various factors. Competent authorities should also consider whether there are other features of the transaction outside of premia, such as fees, which effectively increase the cost of the protection being provided to the extent that credit risk transfer will be undermined.

4. Where premia are paid up-front, or not linked to losses in the asset pool being protected or otherwise guaranteed, competent authorities should consider if this reduces the extent of credit risk transfer.

8. SRT to third parties

1. It is important that significant credit risk is transferred to genuine third parties who are not connected to the originator institution; if this is not the case, excluding the securitised exposures from the calculation of own funds requirements or claiming capital relief from the securitisation transaction will not be justified. Competent authorities should consider whether the investors or credit protection providers are independent from the originator institution, and also whether the originator institution provides the third parties with significant financing.

Explanatory Box
Independent third party means a third party that has no legal or other type of connection to the originator institution that might undermine the credit risk transfer.

9. Credit ratings

1. Where an originator institution is using the Ratings Based Method as specified in Article 261 of Regulation (EU) No 575/2013 to calculate the own funds requirements for its exposures to a securitisation, competent authorities should consider whether the chosen credit rating agency has appropriate experience and expertise in the asset class being rated insofar as the competent authorities are aware.

10. Internal policies for assessing transfer of credit risk and SRT

1. Competent authorities should consider whether the originator institution has appropriate internal policies for making its own assessment of credit risk transfer and SRT. This should include not only an initial assessment of the transaction when the originator institution is first seeking the exclusion of securitised exposures from the calculation of risk-weighted exposure amounts and, as relevant, expected loss amounts, but should also consider the ongoing assessment of SRT during the life of the transaction.

Title IV – Requirements for originator institutions

Part 1 - General requirements for all transactions claiming SRT under Article 243 and 244 of Regulation (EU) No 575/2013

11. Requirements relating to SRT

1. Originator institutions should provide the competent authority with all requested information of the securitisations on which they intend to demonstrate SRT, so that competent authorities can conduct the assessment of SRT to third parties as specified in Title I to Title III of these Guidelines.

2. As a minimum, originator institutions should notify the relevant competent authority of any securitisation on which they intend to demonstrate SRT which is not similar in structure and portfolio composition to previous transactions notified by the institution.

12. Governance and policies around SRT assessments

1. Originator institutions should have a governance process in place for evaluating transactions claiming SRT. This process should include details of relevant committees, any internal

approval procedure, and evidence of appropriate stakeholder involvement and a suitable, auditable trail of documentation.

2. Originator institutions should have appropriate systems and controls regarding SRT through securitisation, including for the ongoing monitoring of SRT requirements and periodic review throughout the maturity of relevant transactions.

3. Originator institutions should have policies and methodologies in place that ensure ongoing compliance with all SRT requirements according to Articles 243 and 244 of Regulation (EU) No 575/2013.

Part. 2 - Specific requirements for originator institutions in order to comply with Article 243(4) or 244(4) of Regulation (EU) No 575/2013

13. Risk-management and self-assessment

1. Originator institutions should have policies and methodologies in place that ensure the possible reduction of own funds requirements achieved by originator institutions through securitisation is justified by a commensurate credit risk transfer to third parties.

2. Originator institutions' SRT policies should be part of their broader capital allocation strategies; in particular, the originator institutions' policies on transfer of credit risk and SRT to third parties should specify how transactions claiming SRT align with originator institutions' overall risk management strategies and internal capital allocation.

3. Originator institutions should make an assessment of the risks involved on any potential transaction claiming SRT, including an assessment of the risk of the underlying assets, an assessment of the securitisation structure itself considering the credit risk of the tranches and other relevant factors that affect the substance of credit risk transfer.

4. When conducting their SRT assessment, originator institutions should also consider whether the possible reduction of own funds requirements is in line with the economic credit risk transfer achieved, for example by comparing the effects of the securitisation on originator institutions' economic capital and on originator institutions' own funds requirements.

5. Originator institutions should analyse whether they can prudently afford the premia payable under the relevant transactions given their earnings, capital, and overall financial condition.

14. Other requirements

1. Originator institutions should use appropriate methods and procedures to assess and demonstrate SRT.

2. Originator institutions should assess the expected loss (EL) and the unexpected loss (UL) of the securitised assets throughout the maturity of the transaction when conducting an SRT assessment.

3. Originator institutions should consider the transaction structure and structural features of the securitisation, for example, if the transaction is cash or synthetic, any hedging techniques or maturity mismatches, if any.

4. In order to identify such factors that may undermine the transfer of credit risk and SRT to third parties originator institutions should evaluate the degree of credit risk mitigation or credit risk transfer of a transaction considering, amongst others, factors such as the following, to the extent applicable:

a. A comparison of the present value of premia and other costs not yet recognised in own funds relative to losses of the protected exposures over a variety of stress scenarios;

b. The pricing of the transaction relative to market prices, including appropriate consideration of premium payments;

c. The timing of payments under the transaction, including potential timing differences between the originator institutions' provisioning for or write downs of the protected exposures and payments by the protection seller;

d. A review of applicable call dates to assess the likely duration of the credit protection obtained relative to the potential timing of future losses on the protected exposures;

e. An assessment of counterparty credit risk, in particular an analysis of whether certain circumstances could lead to the originator institutions' increased reliance on the counterparty providing credit protection at the same time that the counterparty's ability to meet its obligations is weakened;

f. The nature of the link between the different entities involved in the transaction (originator, arranger, investors, protection seller etc);

g. The existence of implicit forms of credit enhancement;

h. The thickness of the mezzanine and junior tranches relative to the credit risk profile of the underlying exposures; and

i. An assessment of the credit risk of the underlying assets: this could be achieved through stresses applied to the underlying assets, an assessment of the payment profile of the exposure to the underlying assets' credit risk, evaluation of key credit risk factors (i.e. LGD, PD, EAD, conversion factors etc.).

Title V – Final provisions and implementation

1. Date of application

1. National competent authorities should implement these Guidelines by incorporating them in their supervisory procedures within six months after publication of the final Guidelines. Thereafter, national competent authorities should ensure that institutions comply with them effectively.

5. Accompanying documents

5.1 Draft Cost- Benefit Analysis / Impact Assessment

Introduction

1. Article 16(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any guidelines developed by the EBA are submitted to the Commission for adoption, they shall be accompanied by an analysis of 'the potential related costs and benefits'. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

2. The analysis of the draft Guidelines on the methodology proposed for assessing whether commensurate credit risk has been transferred to third parties in accordance with Article 243(4) or 244(4) CRR.

Scope and nature of the problem

Issues identified by the European Commission

3. Securitisation can help institutions to efficiently manage their balance sheet and diversify their funding sources. It is also a recognised credit mitigation tool, which can significantly reduce credit risk by transferring it to a third party. However the increased complexity of these instruments makes it harder to understand to which extent risks have effectively been transferred or mitigated. This opacity may also create incentives for firm to arbitrage between the securitisation framework and the credit risk framework in order to benefit from reduction in own funds.

Objectives of the Guidelines

4. In article 243(6) and 244(6) of the CRR, the European Commission mandates the EBA to monitor the range of practices regarding the use of SRT and to specify guidelines regarding the assessment of SRT. This is to avoid that national supervisory authorities have substantially divergent approach regarding the matters that need to be assessed when reviewing whether a credit risk transfer is justified, which may create uncertainty regarding the reduction in capital requirements achieved from the securitisation framework across the EU.

5. The Guidelines specify which criteria competent authorities should use to assess whether a credit risk transfer is justified, and which requirements institutions should meet to facilitate this assessment. The requirements proposed in these Guidelines aim to achieve the following two objectives:

   (1) To clarify the ways in which a firm can demonstrate that there is significant transfer of credit risk from its balance sheet.

   (2) To provide competent authorities with a framework to make decisions on the assessment of SRT that is as uniform as possible, in order to allow harmonised practices across member states.

6. The proposed guidelines seek through these two objectives to ensure that the reduction in capital requirements achieved from the securitisation framework is justified by the transfer of credit risk to third parties.

Technical options considered

7. This section explains the rationale behind some of the choices that the EBA has made when designing the guidelines. The main principle followed was that a credit risk transfer will only be considered significant when the proportion transferred is commensurate with, or exceeds, the proportionate reduction in regulatory capital when comparing the firm's securitisation positions and the underlying exposures.

8. The Guidelines have been drafted to provide more guidance on the assessment of SRT according to Article 243 or Article 244 of the CRR and apply to both originator institutions and competent authorities. The guidelines include i) requirements for originator institutions when engaging in securitisation transactions for SRT, ii) criteria for competent authorities to assess transactions that claim SRT using Articles 243(2) or 244(2) and iii) requirements for competent authorities when assessing whether commensurate credit risk has been transferred to third parties in accordance with Articles 243(4) or 244(4). The scope of the Guidelines goes partly beyond the CRR mandate where this is considered necessary by the EBA.

Requirements for originators institutions

9. These guidance set out some details of the procedures that institutions will need to undertake and the information institutions should provide to the competent authority when they are seeking to reduce their capital requirements by undertaking securitisation.

Requirements for competent authorities

10. The guidelines establishes which criteria and test competent authorities should follow when they make an assessment of whether the reduction in risk-weighted exposure amounts is justified by a commensurate transfer of credit risk to third parties.

Costs

11. Although the assessment of SRT by competent authorities is a requirement that has been in place since CRDII, different practices have been followed across member states and the proposed guidelines will therefore require some adjustment for institutions. There will be two types of costs:

12. **Costs for national supervisory authorities –** The main direct cost for supervisory authorities will be in relation to the processes for assessing significant risk transfer. The guidelines specifies what matters the competent authority must assess and provides for criteria against which credit risk transfers have to be tested. As a result, these guidelines will generate additional compliance costs within those Member States which currently conduct less extensive checks than those proposed by the guidelines. Such costs for the competent authorities will be mainly driven for instance by the need to change some of their IT or system framework, to train existing staff or hire additional staff members.

13. **Costs for institutions –** The main costs for institutions will be related to setting up processes in order to be able to disclose the necessary information and evidence to the competent authorities.

14. The compliance costs of these guidelines are likely to vary between jurisdictions. Some competent authorities are already conducting assessments which meet the criteria presented in the guidelines, and therefore will require them only very few additional resources, whereas in a few other jurisdictions where such assessment are not so frequent, competent authorities and institutions may have to have bear larger costs.

Benefits

15. By specifying the matters that competent authorities must assess when reviewing whether a credit risk transfer is justified due to a securitisation, these guidelines ensures that competent authorities uses the same methodology to establish whether a transfer of significant credit risk will be deemed to have taken place in a given case.

5.2 Overview of questions for Consultation

Q1: Are the Guidelines, and in particular the general and specific requirements for originator institutions, in order to comply with Article 243(4) or 244(4) of Regulation (EU) No 575/2013 clear and complete? Please specify in your answer the current practices in your institution relating to the assessment of SRT.