The Revised Securitisation Framework and the STS Regime

REGULATION (EU) 2017/2402 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 12 December 2017

laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank ([1]),

Having regard to the opinion of the European Economic and Social Committee ([2]),

Acting in accordance with the ordinary legislative procedure ([3]),

Whereas:

(1) Securitisation involves transactions that enable a lender or a creditor – typically a credit institution or a corporation – to refinance a set of loans, exposures or receivables, such as residential loans, auto loans or leases, consumer loans, credit cards or trade receivables, by transforming them into tradable securities. The lender pools and repackages a portfolio of its loans, and organises them into different risk categories for different investors, thus giving investors access to investments in loans and other exposures to which they normally would not have direct access. Returns to investors are generated from the cash flows of the underlying loans.

(2) In its communication of 26 November 2014 on an Investment Plan for Europe, the Commission announced its intention to restart high-quality securitisation markets, without repeating the mistakes made before the 2008 financial crisis. The development of a simple, transparent and standardised securitisation market constitutes a building block of the Capital Markets Union (CMU) and contributes to the Commission's priority objective of supporting job creation and a return to sustainable growth.

(3) The Union aims to strengthen the legislative framework implemented after the financial crisis to address the risks inherent in highly complex, opaque and risky securitisation. It is essential to ensure that rules are adopted to better differentiate simple, transparent and standardised products from complex, opaque and risky instruments and to apply a more risk-sensitive prudential framework.

REGULATION (EU) 2017/2401 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 12 December 2017

amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank ([1]),

Having regard to the opinion of the European Economic and Social Committee ([2]),

Acting in accordance with the ordinary legislative procedure ([3]),

Whereas:

(1) Securitisations are an important constituent part of well-functioning financial markets insofar as they contribute to diversifying the funding and risk diversification sources of credit institutions and investment firms ('institutions') and releasing regulatory capital which can then be reallocated to support further lending, in particular the funding of the real economy. Furthermore, securitisations provide institutions and other market participants with additional investment opportunities, thus allowing portfolio diversification and facilitating the flow of funding to businesses and individuals both within Member States and on a cross-border basis throughout the Union. Those benefits should however be weighed against their potential costs and risks, including their impact on financial stability. As seen during the first phase of the financial crisis starting in the summer of 2007, unsound practices in securitisation markets resulted in significant threats to the integrity of the financial system, namely due to excessive leverage, opaque and complex structures that made pricing problematic, mechanistic reliance on external ratings or misalignment between the interests of investors and originators ('agency risks').

(2) In recent years, securitisation issuance volumes in the Union have remained below their pre-crisis peak for a number of reasons, including the stigma generally associated with such transactions. In order to prevent a recurrence of the circumstances that triggered the financial crisis, the recovery of securitisation markets should be based on sound and prudent market practices. To that end, Regulation (EU) 2017/2402 of the European Parliament and of the Council ([4]) lays down the substantive elements of an overarching securitisation framework, with criteria to identify simple, transparent and standardised ('STS') securitisations and a system of supervision to monitor the correct application of those criteria by originators, sponsors, issuers and institutional investors. Furthermore, that Regulation provides for a set of common requirements on risk retention, due diligence and disclosure for all financial services sectors.

Consolidation and reform of existing securitisation rules on due diligence, risk retention, disclosure and credit–granting.

Creation of a new framework for simple, transparent and standardised (STS) securitisations.

Implementation of the revised Basel securitisation framework, including hierarchy of approaches and risk weights and introduces a preferential capital regime for positions held in STS securitisations by credit institutions and investment firms.

The EBA Discussion Paper on SRT and the PRA Consultation Paper

Amendment proposals for further standardisation of the process for evaluating SRT including the adoption of uniform precautions and certain structural features.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper | CP12/18

Securitisation: The new EU framework and Significant Risk Transfer

May 2018

By responding to this consultation, you provide personal data to the Bank of England. This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the response itself.

The response will be assessed to inform our work as a regulator and central bank. We may use your details to contact you to clarify any aspects of your response.

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Please indicate if you regard all, or some of, the information you provide as confidential. If the Bank of England receives a request for disclosure of this information, we will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England.

Responses are requested by Wednesday 22 August 2018.

DISCUSSION PAPER ON THE SIGNIFICANT RISK TRANFER IN SECURITISATION

EBA EUROPEAN BANKING AUTHORITY

1. Regulatory treatment of SRT and EBA mandate

This chapter provides an introduction to the concept of the significant risk transfer (SRT) in securitisation. It describes its regulatory treatment in the context of the existing and the new EU securitisation framework. It then introduces the EBA mandate on SRT as envisaged in the current and amended CRR as well as the structure of the EBA analysis undertaken in this Discussion Paper in response to the regulatory mandate.

1.1 Objectives and drivers of the significant risk transfer

9. The CRR[1] allows the originator of a securitisation transaction to exclude the securitised exposures from the calculation of its risk-weighted exposure amounts, while risk weighting any retained position in the securitisation transaction, provided that the capital relief is justified by a significant transfer of risk (SRT) associated with the securitised exposures to third parties, i.e. provided that the transaction achieves regulatory SRT.

10. The actual extent of capital relief depends on many factors, including the amount of securitisation positions the originator decides to retain, the asset class of the underlying exposures and the specific capital structure of the securitisation transaction, and is in any case mitigated by the principle of non-neutrality of securitisation capital embedded in the Basel and CRR securitisation frameworks[2].

11. For the SRT to be achieved, it is not necessary to transfer the entire risk of the portfolio. However, the overarching principle for the concept of SRT is that any reduction in own funds requirements must be matched a by a transfer of risk that is significant and commensurate. The main focus of the supervisory assessments by the competent authorities is therefore to ensure that significant and commensurate risk transfer effectively occurs, so as to justify the capital relief achieved by the originator, not only according to the conditions set out in legislation, but also as regards the economic substance of each specific transaction. A capital relief not justified by an effective risk transfer would result in a weakening of the capital position of the institution.

Discussion on implementing certain matters related to the Revised Securitisation Framework, as well as certain updated expectations on the part of the PRA with regard to SRTs.

Other considerations and investor concerns

What is the impact of SRT on the Bank's accounting treatment of the underlying loans under IFRS 9?

Introduction

Reasons for issuing the IFRS

IN1 IAS 39 *Financial Instruments: Recognition and Measurement* sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. The International Accounting Standards Board (IASB) inherited IAS 39 from its predecessor body, the International Accounting Standards Committee.

IN2 Many users of financial statements and other interested parties have told the Board that the requirements in IAS 39 are difficult to understand, apply and interpret. They have urged the Board to develop a new standard for financial reporting for financial instruments that is principle-based and less complex. Although the Board has amended IAS 39 several times to clarify requirements, add guidance and eliminate internal inconsistencies, it has not previously undertaken a fundamental reconsideration of reporting for financial instruments.

IN3 Since 2005, the IASB and the US Financial Accounting Standards Board (FASB) have had a long-term objective to improve and simplify the reporting for financial instruments. This work resulted in the publication of a discussion paper, *Reducing Complexity in Reporting Financial Instruments*, in March 2008. Focusing on the measurement of financial instruments and hedge accounting, the paper identified several possible approaches for improving and simplifying the accounting for financial instruments. The responses to the paper indicated support for a significant change in the requirements for reporting financial instruments. In November 2008 the IASB added this project to its active agenda, and in December 2008 the FASB also added the project to its agenda.

IN4 In April 2009, in response to the input received on its work responding to the financial crisis, and following the conclusions of the G20 leaders and the recommendations of international bodies such as the Financial Stability Board, the IASB announced an accelerated timetable for replacing IAS 39. As a result, in July 2009 the IASB published an exposure draft *Financial Instruments: Classification and Measurement*, followed by IFRS 9 *Financial Instruments* in November 2009.

Concerns from the buy-side

Basel IV in a Nutshell

- *Calculation of capital ratios under Basel III/CRR…*

Common equity tier 1 capital

Additional tier 1 capital

Tier 2 capital

Credit risk | **Market risk** | **OpRisk**

> **8% + capital buffers**

Other topics

- Ban on use of internal models-based approach and introduction of a standardised approach for CVA
- Global standard for large exposures with harmonised definition on exposures and groups of connected clients
- Standardised disclosure templates and new disclosure requirement for all new RWA approaches
- New rules for securitisation RWA and STS securitisations
- Pillar II and indirect Pillar I requirements on step in risk
- Phase-in of 'old' Basel III rules

Individual impact on banks depending on:

- Business model
- Use of internal model
- MARKET competition
- Interest rate level
- Profitability

Contagion effect for all financial markets

- Asset managers
- Pension funds
- Hedges funds
- Insurance companies

Basel IV will not only be one of the biggest challenges for banks going forward, but also a opportunity for other financial markets participants.

Recalibration of Basel III as the next generation of RWA or Basel IV ?

RWA impact varies depending on business model, clients, products and extend of use of internal models