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19 June 2018

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# Consultation Paper

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Draft Regulatory Technical Standards

on the conditions to allow institutions to calculate  $K_{IRB}$  in accordance with the purchased receivables approach under Article 255 of [Regulation (EU) 2017/2401 amending Regulation (EU) No 575/2013]

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# Responding to this consultation

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The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 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 should consider.

## Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 19.09.2018. 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.

## Executive Summary

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Regulation (EU) No 575/2013<sup>1</sup> as amended by Regulation (EU) 2017/2401<sup>2</sup> (the CRR hereafter) provides that institutions may calculate K<sub>IRB</sub> in relation to the securitised exposures in accordance with the provisions set out in Part Three, Title II, Chapter 3 of the CRR for the calculation of capital requirements for purchased receivables, and mandates the EBA to prepare draft Regulatory Technical Standards in this area. The CRR requires the EBA to submit the draft Regulatory Technical Standards to the Commission by 18 January 2019.

### Main features of the RTS

The draft Regulatory Technical Standards, in accordance with Article 255(9) of CRR, should specify in greater detail the conditions to allow institutions to calculate K<sub>IRB</sub> for the underlying pools of securitisation in accordance with paragraph 4 of article 255 of CRR, in particular with regard to:

- a) internal credit policy and models for calculating KIRB for securitisations;
- b) use of different risk factors relating to the underlying pool and, where sufficient accurate or reliable data on the underlying pool is 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.

These draft RTS are developed to strike the right balance between the need to acknowledge the specific circumstances of institutions calculating capital requirements in the context of a securitisation transaction and the need to maintain appropriately safe and prudent requirements on the internal modelling of capital requirements, making the IRB provisions workable in a securitisation context, and taking into account the different roles that an institution calculating K<sub>IRB</sub> in relation to a given securitisation transaction may play in the context of that transaction.

In order to achieve such balance, and maximise legal clarity, the draft RTS clearly specify that the entire set of both Level 1 and Level 2 regulations as well as the Guidelines related to the IRB framework apply to institutions calculating K<sub>IRB</sub> in accordance with Article 255(4), unless specified differently in the context of the RTS.

The draft RTS identify the servicing of the securitised exposures as the key condition determining whether the institution calculating K<sub>IRB</sub> shall be allowed to compute K<sub>IRB</sub> in accordance with Article 255(4). Where the institution calculating K<sub>IRB</sub> is not the servicer of the securitised exposures, that

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

<sup>2</sup> Regulation of the European Parliament and the Council No 2401/2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

institution is deemed to be in a condition of limited control and access to information in relation to the securitised exposures, which is comparable to the condition of an institution purchasing receivables in accordance with the credit risk framework. Even though the Level 1 text of the CRR provides institutions with the option of using the requirements for the calculation of purchased receivables in the calculation of K<sub>IRB</sub> the EBA is of the view that, in all cases where exposures are not serviced by the institution calculating K<sub>IRB</sub>, institutions should compute K<sub>IRB</sub> in accordance with the rules that are specific to purchased receivables, in particular as further specified in the RTS. Supervisors should expect institutions to do so because the purchased receivables framework, as further specified in the draft RTS, includes a set of obligations which are deemed to be necessary to maintain a minimum degree of prudence in the use of internal models on exposures that the institution using the models does not service.

The draft RTS provides that institutions shall use rating systems whose range of application only includes securitised exposures that they do not service. The EBA is of the view that the use of common rating systems for exposures that are serviced by the institution calculating capital and exposures that are not serviced by that institution is not appropriate, as the two types of exposures are necessarily managed in different ways. In particular, the IRB estimation standards achieved on the exposures that the institution services might be biased or compromised by the different management standards and data used in relation to the exposures in the scope of this Regulation.

The draft RTS also specifies that the 3 years prior experience normally required by CRR on each new rating system shall not be required when the institution applies to obtain permission to use a rating system for the purposes of CRR Article 255(4). The experience gained by the institution as a result of having received prior IRB permission for at least one rating system used under the general credit risk framework for the exposure class to which the securitised exposures are assigned, which in the context of the draft RTS is the pre-condition for the institution to be eligible for the SEC-IRBA method, is deemed sufficient for the institution to be able to obtain an IRB permission on the specific rating system under consideration, without having to use such rating system for 3 years prior to applying.

The CRR purchased receivables framework envisages, under specific conditions, facilitated estimation requirements for corporate purchased receivables. Among others, it provides that institutions may use retail risk quantification standards, instead of corporate standards, on eligible corporate purchased receivables. In this regard, the RTS reformulates Article 154(5) and Article 184 of the CRR, in order to make them workable and meaningful in a securitisation transaction context, as opposed to the portfolio purchase context for which they were originally designed. In doing this, the draft RTS also take into account the rationale of the requirements on purchased receivables as expressed in the corresponding Basel standards. The requirement whereby institutions may only use retail risk quantification standards on corporate purchased receivables where it would be unduly burdensome for them to apply corporate risk quantification standards is further specified with respect to its credit risk framework high level wording, in order to ensure that such facilitation in the estimation process may only be adopted where justified by concrete factors and conditions.

Furthermore, the RTS states that the term 'proxy data' encompasses the concepts of 'internal data', 'external data' or 'pooled data', as already referred to in the CRR for the calculation of capital requirements, and sets out that the requirements on conservatism when institutions make use of data in the course of the estimation, shall also apply when they use proxy data for the purposes of model development, calibration of risk parameters and application of the rating system for calculating K<sub>IRB</sub>.

The CRR purchased receivables framework not only includes specific IRB provisions on the estimation of risk parameters (PD, LGD and CCFs), but also includes other provisions that are not explicitly addressed in the RTS as the corresponding CRR provisions specific to purchased receivables can be smoothly applied in a securitisation context to exposures underlying the securitisation, for the calculation of K<sub>IRB</sub>, where applicable and without further specification.

## Next steps

Following the conclusion of the consultation period, the draft Regulatory Technical Standards will be finalised and submitted to the European Commission for adoption.

## Background and rationale

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### The new Basel securitisation framework implemented in the EU

1. Regulation (EU) 2017/2401 (the Regulation amending CRR hereafter), and the accompanying amendments to the securitisation framework of Regulation (EU) 2013/575 (the CRR hereafter), introduce in the European Union three new approaches to the calculation of capital requirements on securitisation positions, SEC-IRBA, SEC-SA and SEC-ERBA, in accordance with the July 2014 revision of the Basel securitisation framework. SEC-IRBA and SEC-SA are formulae-based approaches that require, among other inputs, the capital requirement on the exposures underlying the securitisation transaction. SEC-ERBA is based on external ratings and does not depend on the capital requirement of the securitised exposures. In the case of SEC-IRBA, the capital requirement on the securitised exposures, including expected loss, is named  $K_{IRB}$  and must be computed in accordance with the Internal Ratings-Based Approach (IRB) of the CRR credit risk framework.
2. In accordance with the Basel standards, the amended CRR provides that SEC-IRBA ranks first in the hierarchy of approaches that are available to compute capital requirements. Institutions may use SEC-IRBA when the securitised exposures are of a type in relation to which they have permission to use the IRB Approach and are able to calculate risk-weighted exposure amounts in accordance with the IRB Approach for at least 95% of the underlying exposure amount. In addition, institutions may only use SEC-IRBA when sufficient information is available on the securitised exposures for them to be able to calculate  $K_{IRB}$ . Whereas the current securitisation framework provides that a specific supervisory permission is needed for institutions other than originators to use the IRB formulae-based approach to securitisation capital (in the current framework called Supervisory Formula Method), the Regulation amending CRR removes that specific approval and makes the use of SEC-IRBA only conditional on the IRB permissions of the credit risk framework and on the availability of sufficient information to compute  $K_{IRB}$ .
3. In line with the Basel securitisation framework, the Regulation amending CRR further specifies that when using SEC-IRBA institutions may use the provisions of the so-called purchased receivables approach of the IRB framework of the CRR (Part Three, Title II, Chapter 3 of the CRR) in order to compute  $K_{IRB}$ . The Regulation amending CRR specifies

that ‘proxy data’ may be used where sufficient, accurate or reliable data on the securitised exposures is not available for the calculation of K<sub>IRB</sub>.

4. Overall, the amendments of the securitisation framework aim at reducing the reliance on external ratings in the calculation of capital requirements and at facilitating the use of the SEC-IRBA by institutions other than originators.

## The purchased receivables approach

5. In accordance with the Basel standards on the IRB Approach, the IRB framework of the CRR includes specific rules on the treatment of purchased receivables. The term ‘purchased receivables’ is not defined in either the Basel framework or the CRR. Purchased receivables can broadly be referred to as credit exposures that institutions purchase from third parties, either corporate entities (e.g. factoring business) or other financial institutions (e.g. loan portfolio sale). In either case one or more of the following circumstances occur: i) the purchasing institution did not originate the obligation underlying the receivable; ii) the obligor of the receivable may not be a customer of the purchasing institution and may not be informed that the ownership of his/her credit obligation has been transferred to the purchasing institution; iii) the purchasing institution may rely on a third party, e.g. the seller of the receivables, a servicer or other third-party entity, for part of or the whole process of management and/or servicing of the receivables.
6. Given the above features, the IRB rules that are specific to purchased receivables ensure that:
  - (a) From an operational perspective the purchasing institution exercises sufficient control and due diligence on the purchased receivables as well as on all the entities involved in the transaction, i.e. the seller, the obligors and, where applicable, the servicer. The risk quantification, operational and due diligence requirements (Article 184 of the CRR) are minimum requirements that the institution shall comply with where it computes capital requirements on the purchased receivables in accordance with the IRB Approach;
  - (b) As regards the IRB parameters estimation, given the likelihood that the purchasing institution may not have access to complete and fully reliable information on the purchased receivables – as opposed to the exposures it originates and holds on its balance sheet – the purchasing institution may apply, under certain conditions, less stringent IRB requirements on corporate purchased receivables. In particular, institutions may be allowed to apply retail risk quantification standards to eligible corporate purchased receivables, and may be allowed to estimate the probability of default (PD), and also loss given default in the case of institutions with a permission to use own estimates of LGD, by decomposing estimates of expected losses, where the PD or LGD



parameters may not be appropriately estimated according to the IRB requirements (Article 160, Article 161 and Article 170 of the CRR);

- (c) In the case of retail purchased receivables, the purchasing institution takes into account the underwriting standards and customer heterogeneity of the seller for the purposes of risk differentiation, as well as all available internal and external data, given that the institution itself did not originate the purchased receivables. In addition, the institution may apply retail risk quantification standards under certain conditions, which allows for the estimation of risk parameters at pool level and for the decomposition of estimates of expected losses (Article 170, Article 180(2)(b) and Article 181(2)(a) of the CRR);
- (d) The purchasing institution appropriately calculates dilution risk on the purchased receivables unless the institution can demonstrate that dilution risk is immaterial for the respective type of exposures. Whereas it may arise in relation to any receivables, dilution risk is more likely to arise on receivables originated by corporate entities, e.g. trade receivables.

7. Unlike the CRR, the Basel standards on the treatment of purchased receivables explicitly define the risk quantification procedure applicable to both eligible corporate purchased receivables and retail purchased receivables as 'top-down' approach. The standards specify that the top-down approach must comply with the retail risk quantification standards and that 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.

## The application of provisions on purchased receivables to SEC-IRBA

8. These draft RTS are developed to strike the right balance between the need to acknowledge the specific circumstances of institutions calculating capital requirements in the context of a securitisation transaction and the need to maintain appropriately safe and prudent requirements on the internal modelling of capital requirements. In this regard, variability of risk weighted exposure amounts due to modelling practices is a widely acknowledged undesirable implication of the use of internal models that both the BCBS and the EBA have been working to address. Also, from a prudential perspective and against the backdrop of the global securitisation market's performance during the crisis, it would not be appropriate to set IRB requirements applicable to the securitisation framework that are more flexible than those currently applicable, where this is not justified by sufficiently stringent and objective operational conditions.

9. An explicit link between the purchased receivables framework and the use of internal models in securitisation is acknowledged in the Basel standards. Paragraph 241 of the Basel II standards provide that *'Primarily it [the top-down approach] is intended for receivables that are purchased for inclusion in asset-backed securitisation structures, but banks may also use this approach, with the approval of supervisors, for appropriate on-balance sheet exposures that share the same features'*.
10. In order to define the conditions under which the IRB provisions on purchased receivables may be used for the calculation of K<sub>IRB</sub> these RTS are developed taking into account the different roles that an institution calculating K<sub>IRB</sub> may play in the context of the transaction.
11. In relation to securitised exposures that are not serviced by the institution calculating K<sub>IRB</sub> (this might be the case of investor institutions, sponsor institutions, but also originator institutions not servicing part or all of the securitised exposures):
- The risk quantification, operational and due diligence requirements related to purchased receivables (Article 184 of the CRR) are deemed essential to ensure that institutions may exercise a sufficient degree of control over the securitised exposures and that they have access to information and data that are sufficiently accurate for the IRB Approach to be applicable on those exposures. Furthermore, those rules ensure that institutions calculating K<sub>IRB</sub> carry out sufficient due diligence analysis on all the parties involved in the securitisation transaction that may affect the accuracy of the K<sub>IRB</sub> calculation;
  - Institutions must take into account the original lender's underwriting practices and heterogeneity of customers, where they are not the original lender of the securitised exposures;
  - Because of the limited availability of data on the securitised exposures as well as the limited control over those exposures, institutions may justifiably apply to eligible non-retail securitised exposures the less stringent IRB requirements foreseen for eligible purchased corporate receivables;
  - Because of the limited availability of data on the securitised exposures, institutions may benefit from the use of 'proxy data', as referred to in the mandate given to the EBA in relation to these RTS.
12. The above considerations are justified also in relation to those investors that are investing in securitisation positions originated by other institutions with which they share IRB models based on pooled data. This is for the reason that the use of pooled data models does not substantially change the level of control that the investor can exercise on the securitised exposures, nor does it affect the flow of data that it receives in relation to those exposures.

13. The servicing of the securitised exposures is considered a key factor in determining the degree of control that the institution calculating K<sub>IRB</sub> may achieve over the securitised exposures as well as the quantity and quality of information that the institution may receive in relation to those exposures and which is necessary for an accurate K<sub>IRB</sub> calculation. For these reasons, the provisions on the calculation of capital requirements for purchased receivables are deemed appropriate only in relation to securitised exposures that the institution calculating K<sub>IRB</sub> does not service.
14. The proposed standards leave some flexibility to the institution in those cases where the institution is the servicer of some, but not all, the securitised exposures of a given securitisation transaction in relation to which the institution shall calculate K<sub>IRB</sub>. The requirements do not preclude the institution calculating K<sub>IRB</sub> from splitting the exposures underlying a securitisation in sub-pools in order to calculate K<sub>IRB</sub> separately, as long as each sub-pool meets the corresponding provisions set out in the CRR. In this vein, the institution may calculate K<sub>IRB</sub> in accordance with Article 255(4) of the amended CRR and this Regulation for the sub-pool of exposure for which it is not the servicer, and in accordance with the other provisions of Article 255 of the CRR, and the IRB provisions that are not specific to purchased receivables, for the sub-pool of exposures in the transaction that they service. It is worth stressing that, as a consequence of what is set out in Article 258 of the amended 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<sub>IRB</sub> in accordance with the CRR and this Regulation, in which case the K<sub>SA</sub> of those exposures shall be taken into account in the way foreseen in Article 259(7) of the amended CRR.
15. Securitised exposures that are not serviced by the institution calculating K<sub>IRB</sub> cannot be considered to be homogeneously managed with respect to exposures, either securitised or not securitised, for which the institution calculating K<sub>IRB</sub> is the servicer, for reasons of different degree of control and access to information explained in the previous paragraphs. Due to the different type of management, it is not appropriate that exposures that are in the scope of these RTS be treated under the same rating systems used by institutions for exposures that are not in the scope of these RTS. For this reason, the RTS require that institutions use tailor-made internal models for calculating K<sub>IRB</sub> where such calculation is done in accordance with Article 255(4) of the CRR. Using common rating systems may bias or otherwise worsen the estimation outcomes for exposures that institutions service, including the vast majority of on balance sheet exposures, for which the institution is the original lender and servicer.
16. Prior to applying for permission for a tailor-made internal model for calculating K<sub>IRB</sub> and related rating systems, in accordance with this Regulation, institutions shall be considered eligible to use SEC-IRBA, in accordance with Article 258(1) of the amended CRR, as long as they already have prior permission to use at least one rating system within the exposure class to which the securitised exposures are assigned.

17. Any such permission for a tailor-made rating system for the calculation of K<sub>IRB</sub> should be based on a prior assessment of rating system in terms of their compliance with all the requirements set out in this Regulation. When applying for such permission, institutions shall not have to meet the requirement of having been using the rating system under consideration for at least 3 years prior to applying, as the experience gained in the use of at least one rating system for which the institution must already have permission in the same exposure class, shall be deemed sufficient in this context.
18. It is expected that a given internal model for calculating K<sub>IRB</sub> that has received prior permission to be used in accordance with this Regulation, may be used repeatedly and in the context of investments in different securitisation transactions, where the securitised exposures of these different transactions may be considered to fall in the range of application of that rating system. In this regard any changes to an internal model for calculating K<sub>IRB</sub> and related rating systems, or to their range of application, after the required prior permission has been obtained, should be assessed in terms of regulatory treatment in accordance with the already existing CRR provisions on model changes.
19. Regarding non-retail securitised exposures, in accordance with Article 153(6) of CRR, institutions shall use the retail risk quantification standards (called ‘top-down’ approach in the Basel standards) when the conditions of Article 154(5) and Article 184 of CRR are met, as specified in this Regulation, and when additionally they can justify that it would be unduly burdensome to apply the corporate risk quantification standards as further specified in this Regulation. The ‘unduly burdensome’ condition is further specified in the draft RTS, in order to ensure that the facilitated estimation requirements may only be used when concrete conditions related to the implementation costs and operational capabilities for the institution calculating K<sub>IRB</sub> are verified. Furthermore, a minimum granularity condition is proposed for a given sub-pool of securitised corporate exposures to be eligible for retail risk quantification standards. Lastly, among the conditions to be considered in the context of the assessment, the risk posed to the institution by its overall securitisation investment activity shall be considered.
20. In the case of retail securitised exposures, institutions shall use the retail risk quantification standards when the conditions of Article 184 and Article 154(5)(b) to (d) of CRR are met, as specified in this Regulation. Point (a) of Article 154(5) as further specified in the RTS, whereby “the SSPE has purchased the securitised exposures from unrelated third party originators to the institution calculating K<sub>IRB</sub>, and its exposure to the obligor in the pool of securitised exposures does not include any exposures that are directly or indirectly originated by the institution calculating K<sub>IRB</sub> itself” cannot be applied for the purposes of these RTS. If that point were applied, 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 in accordance with the credit risk

framework of the CRR. The Basel standards take a similar approach, in that the provisions corresponding to the entire Article 154(5) only determine eligibility for the retail treatment of corporate purchased receivables, and not any purchased receivables as in the CRR credit risk framework.

21. It should be understood that internal data (that in the CRR is referred to with respect of the institution calculating capital) is not necessarily to be considered the most accurate data for the use of the internal models and related rating systems for calculating  $K_{IRB}$  in the context of these RTS. This is because, in the context of the RTS, the securitised exposures are not serviced by the institution calculating capital and, in the case of non-originators, the exposures were not even originated by the institution calculating capital. This means that the most accurate sources of data on the securitised exposures, as well as of proxy data (i.e. not directly related to those exposures) may be external or pooled data. For these reasons, the IRB provisions that refer to internal data to be the primary source of data for IRB estimation shall not necessarily apply in the context of the RTS. Also, whenever the IRB provisions require comparability and representativeness of the data used for risk differentiation and risk quantification with respect to the data or lending standards related to the institution's actual exposures and obligors, the corresponding provisions may not always meaningfully be applied in the context of the RTS. In fact, when the internal model for calculating  $K_{IRB}$  uses external data as the most accurate source of data on the securitised exposures in the scope of the RTS, data and lending standards related to the institution calculating  $K_{IRB}$ 's actual exposures and obligors may not be relevant reference.
22. Proxy data to estimate the risk parameters could be used where sufficient accurate or reliable data on the pool of securitised exposures are not available. The term 'proxy data' encompasses the concepts of 'internal data', 'external data' or 'pooled data', as already referred to in the CRR for the calculation of capital requirements for purchased receivables. Proxy data should be used when the available information directly referred to the exposures underlying the securitisation is not sufficient, accurate or reliable. Its use is subject to the requirement of the representativeness of proxy data with regards to the data that they supplement and its detailed specification, when intended to be used, in the internal model for calculating  $K_{IRB}$  in the following situations: model development, calibration of risk parameters and application.
23. When estimating risk parameters and when assigning exposures to grades or pools, it should be necessary to make adjustments and adopt an adequate margin of conservatism with regard to the external data corresponding to the securitised exposures and proxy data. As Article 171(2) of CRR sets out, the less information an institution has, the more conservative shall be its assignment of exposures to obligor and facility grades or pools. This is even more relevant in the case where the definition

of default used in the external data corresponding to the securitised exposures and the proxy data is different from the definition used by the institution calculating K<sub>IRB</sub> in its internal model. Therefore, in order to apply the purchased receivables approach to securitised exposures, this Regulation 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 corresponding to the securitised exposures and proxy data under the scope of this Regulation.

## The optionality in Article 255(4) of the CRR

24. Article 255(4) of the CRR explicitly provides institutions with the possibility of choosing to apply the requirements of the IRB framework of the CRR on purchased receivables in the calculation of K<sub>IRB</sub> (*'institutions may calculate K<sub>IRB</sub> [...]'*).
25. The draft RTS define the conditions to allow institutions to use such provisions, by ensuring that: i) those provisions are only used when the non-servicing condition places the institution calculating K<sub>IRB</sub> in conditions of limited control and access to information on the securitised exposures, justifying access to a set of slightly facilitated estimation requirements; ii) all the requirements of the purchased receivables framework, as further specified in the RTS, apply whenever such conditions of limited control and access to information on the securitised exposures are verified. The latter ensures that the use of the IRB approach remains prudent and adequate in such 'unusual' conditions and that the use of the IRB approach in those conditions may not affect the quality of estimation that the institution achieves by means of using standard internal models and IRB requirements on exposures it has originated and holds on its balance sheet.
26. However, the optionality embedded in Article 255(4) of the CRR is such that institutions may choose not to apply the purchased receivables framework, and these RTS, even when, as a result of not being the servicers of the securitised exposures, it would be prudent for them to do so. Whereas the RTS is not an appropriate instrument to modify a Level 1 requirement, the Recitals of the draft RTS clarify that 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.

# Draft regulatory technical standards

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COMMISSION DELEGATED REGULATION (EU) No .../..

of **XXX**

[...]

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the conditions to allow institutions to calculate  $K_{IRB}$  in relation to the underlying exposures of a securitisation transaction in accordance with the provisions set out in Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013 for the calculation of capital requirements for purchased receivables**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012<sup>3</sup>, and in particular the third subparagraph of Article 255[(9)] thereof,

Whereas:

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<sup>3</sup> OJ L 321, 30.11.2013, p. 6.

- (1) Securitised exposures that the institution calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 does not service, cannot be considered homogeneously managed with respect to similar exposures of the same exposure class, either securitised or not securitised, for which the institution is the servicer. This is because, with regard to the former exposures, the institution will have to rely on the servicing practices and recovery practices of external entities, as well as on external data transmitted by those entities or other external sources, including proxy data. Where the institution calculating K<sub>IRB</sub> is investing in a securitisation transaction originated by third party entities, that institution is generally not the original lender of the securitised exposures, nor is it the servicer of those exposures. In those cases, the exposures under consideration are also related to the lending decision of third parties to the institution. Those factors are such that the institution calculating K<sub>IRB</sub> has limited control and access to information in relation to the securitised exposures, similarly to an institution purchasing receivables under the credit risk framework. It is only in these circumstances that the less stringent estimation requirements generally available for purchased receivables should also be allowed for the purposes of calculating K<sub>IRB</sub>. For these reasons, this Regulation limits the possibility to compute K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 to securitised exposures for which the institution calculating K<sub>IRB</sub> is not the servicer. In addition, as servicing by third parties may have a material impact on the risk drivers relevant for risk differentiation and on the calibration of the risk parameters assigned to individual grades or pools, institutions calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 should use an internal model for calculating K<sub>IRB</sub> that is exclusively used to derive PD, LGD, EL or conversion factor estimates for calculating K<sub>IRB</sub> in accordance with that Article. This means that an internal model used for the purposes of calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 should not be used for the calculation of risk-weighted exposure amounts for exposures, either securitised or not securitised, that the institution services. The required separation between rating systems and internal models for calculating K<sub>IRB</sub> also ensures that the IRB estimation standards achieved on the exposures that the institution services are not biased, compromised or otherwise worsened by the different management standards and data used in relation to the exposures in the scope of this Regulation.
- (2) Given the effect, from a prudential perspective, of the servicing factor on the quality of the rating systems of an institution overall, 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<sub>IRB</sub> in accordance with Article 255(4) of that Regulation. As a result, the optionality of Article 255(4) of Regulation (EU) No 575/2013 is necessarily to be understood as restricted to cases other than those where institutions are deemed to have limited control and limited access to information and data on the exposures underlying the securitisation, 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). In the case of a securitisation with multiple originators, each originator retaining a securitisation position in the securitisation should calculate K<sub>IRB</sub> in accordance with Article 258 of that Regulation by applying this Regulation to the part of the securitised exposures that it is not servicing



and the general IRB provisions for exposures other than purchased receivables to the securitised exposures it is servicing.

- (3) Article 258(1) of Regulation (EU) No 575/2013 provides that for the institution to be allowed to use SEC-IRBA the exposures underlying the securitisation have to be of a type in relation to which the institution has an IRB permission without further differentiating between the different roles, such as originator, servicer, or investor, which an institution may play in a securitisation transaction. In the context of calculating K<sub>IRB</sub> for the purposes of this Regulation, an institution would never be able to comply with the requirement to have received prior permission in accordance with Article 143(2) Regulation (EU) No 575/2013, given that, for the reasons explained in the previous recitals, the securitised exposures not serviced by the institution calculating K<sub>IRB</sub> could never be deemed to be homogeneously managed as similar exposures, either securitised or not securitised, that are serviced by that institution. In such cases, compliance with the requirements of the SEC-IRBA would require compliance with the requirements of this Regulation. Therefore, for the purposes of this Regulation, permission to use SEC-IRBA in accordance with Article 258(1) of Regulation (EU) No 575/2013 should be read to require that the institution calculating K<sub>IRB</sub> has received permission to use the IRB approach in relation to at least one rating system in within the exposure class to which the securitised exposures are assigned.
- (4) As the calculation of K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 necessitates the use of separate rating systems which are tailor-made to this purpose, the requirements of Article 143 of that Regulation, which provide for a prior approval by the relevant competent authorities for each rating system used by institutions, also apply here. As a result, 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<sub>IRB</sub>. Consequently, also the requirements of Delegated Regulation (EU) No 529/2014 on IRB model changes apply where changes occur to an internal model for calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 after the prior permission has been obtained. Similarly, the IRB provisions of Regulation (EU) No 575/2013 relating to dilution risk also apply here.
- (5) Given that the provisions of Regulation (EU) No 575/2013 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, including the terms relating to ‘seller’, ‘purchasing institution’, ‘institution’s exposures and standards’ as well as ‘type of exposures’.
- (6) While the majority of the IRB provisions of Regulation (EU) No 575/2013 are applicable in the case of calculating K<sub>IRB</sub> in accordance with Article 255(4) of that Regulation, 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 securitisation.

- (7) As explained in Recital (3), for an institution to be eligible to use SEC-IRBA in accordance with Article 258(1) Regulation (EU) No 575/2013 for calculating K<sub>IRB</sub> in accordance with Article 255(4) of that Regulation, it shall be sufficient that the institution has received permission to use the IRB approach in relation to at least one rating system in the relevant exposure class. In order to calculate K<sub>IRB</sub> in accordance with Article 255(4), as explained in previous Recitals, this Regulation requires institutions to use tailor-made internal models. When an institution that meets the requirements of Article 258(1) applies for permission to use a rating system as an internal model to calculate K<sub>IRB</sub> in accordance with Article 255(4) and this Regulation, the requirement that the institution shall have been using that rating system for at least three years prior to applying for permission should not apply and the experience the institution has gained by using at least one rating system in the relevant IRB exposure class should be considered sufficient.
- (8) The requirements in Article 184 of Regulation (EU) No 575/2013 aim to ensure that, when estimating risk parameters for purchased receivables, the purchasing institution exercises a sufficient minimum level of control over those receivables on an ongoing basis, has ongoing access to data and information related to the riskiness of the receivables, including from the seller and servicer of the receivables, 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. These operational and due diligence requirements are required to be met in order to ensure a sufficiently prudent and accurate application of the IRB Approach on the purchased receivables. It is therefore necessary to extend the requirements of Article 184 of that Regulation to institutions calculating K<sub>IRB</sub> for the purposes of this Regulation. The institution calculating K<sub>IRB</sub> may exercise indirect control on the exposures underlying the securitisation by means of the SSPE that owns the exposures as well as through a trustee or entity fulfilling equivalent tasks that acts on its behalf and represents its interests in the securitisation transaction. The institution has to exercise due diligence on the servicer of the securitisation transaction and, where the institution itself is not the originator of the transaction, on the securitisation's originator, as originator and servicer's standards and conduct are risk drivers in relation to the exposures underlying the securitisation transaction.
- (9) In the context of securitisation transactions the originator's lending standards and characteristics and the servicer's servicing standards and characteristics are essential risk drivers in relation to the exposures underlying the securitisation. The internal model for calculating K<sub>IRB</sub> has to take due account of these risk drivers, as a minimum, either by considering such risk drivers when assigning the exposures to grades or pools or by using different calibration segments for different originators and different servicers. When the institution calculating K<sub>IRB</sub> is itself the originator of the securitisation, it should not take the originator into account as an additional risk driver. Originator and servicer should be considered as risk drivers as a minimum in the manner specified in this Regulation when a given internal model for calculating K<sub>IRB</sub> for the purposes of this Regulation is applied to multiple different securitisation transactions.
- (10) Institutions calculating K<sub>IRB</sub> for the purposes of this Regulation would be allowed to apply the retail risk quantifications standards to non-retail securitised exposures in accordance with Article 153(6) of Regulation (EU) No 575/2013 where they met both the conditions of Article 154(5), as replaced by this Regulation, and Article 184 of Regulation (EU) No 575/2013, as further specified in this Regulation,

and the institution could justify that it would be unduly burdensome to apply the corporate risk quantification standards as further specified in this Regulation. When any of the conditions of Article 154(5), as replaced by this Regulation, or the unduly burdensome condition as further specified in this Regulation were not met in relation to certain securitised exposures, the institution calculating K<sub>IRB</sub> would not be allowed to apply the retail risk quantification standards to those exposures, but could still apply corporate risk quantification standards to them, provided that they use an internal model for calculating K<sub>IRB</sub> that meets all the requirements of this Regulation.

- (11) Article 154(5) of Regulation (EU) No 575/2013, designed to apply in the context of purchased receivables, aim to ensure that purchasing institutions may not end up applying retail (i.e. less burdensome) risk quantification standards to non-retail exposures they have originated. The Basel standards on purchased receivables clearly specify that the standards corresponding to the requirements in Article 154(5) of Regulation (EU) No 575/2013 only determine eligibility for the retail treatment of corporate purchased receivables. Article 154(5), however, does not explicitly indicate that those eligibility conditions refer only to corporate purchased receivables. In the context of securitisation, where in particular an originator does not service the exposures underlying the securitisation, point (a) of Article 154(5) would prevent the originator from treating under the retail risk quantification standards securitised exposures that it has originated itself and classified as retail exposures in accordance with the credit risk framework of Regulation (EU) No 575/2013. To avoid such a result, this Regulation provides that the requirements of point (a) in Article 154(5) do not apply to retail securitised exposures. Institutions calculating K<sub>IRB</sub> for the purposes of this Regulation would be allowed to apply the retail risk quantification standards to retail securitised exposures the conditions of Article 154(5), as replaced by this Regulation, and those of Article 184 of Regulation (EU) No 575/2013, as further specified in this Regulation.
- (12) In quantifying the risk parameters to be associated with exposures underlying a securitisation for the purposes of this Regulation, it is neither necessary to ensure that the population of exposures represented in the data used for estimation is comparable to the exposures of the institution calculating K<sub>IRB</sub> for the purposes of this Regulation, nor is it necessary that the lending standards used when the data was generated are comparable to the lending standards of the institution calculating K<sub>IRB</sub> for the purposes of this Regulation. Instead, the population of exposures represented in the data used for estimation and the lending standards that generated those data should be comparable with the securitised exposures and the lending standards that applied in the origination of those exposures. Only where the institution calculating K<sub>IRB</sub> for the purposes of this Regulation is the original lender of the exposures underlying the securitisation, although it is not the servicer of those exposures, the comparability of the data used for estimation and the lending standards applied at origination should also be assessed against the exposures and standards of the institution calculating K<sub>IRB</sub> for the purposes of this Regulation. Similarly, given the need to adapt Article 180(2)(c) of Regulation (EU) No 575/2013 to the context of securitisation, internal data (to the institution calculating K<sub>IRB</sub>) should not necessarily be considered to be the best available data, where the exposures have not been originated by the institution calculating K<sub>IRB</sub> for the purposes of this Regulation, and given that the institution is not the servicer of those exposures.
- (13) Given that the provisions of Regulation (EU) No 575/2013 relating to the use of the IRB approach provide for the use of data of a lesser quality where other data is not

available, similarly, proxy data 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 any data not directly referring to the securitised exposures. Further, given that Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013 for the calculation of capital requirements for purchased receivables under the credit risk approach provides for the use of internal, external and pooled data, proxy data in the context of securitisation may also include those three types of data.

- (14) The assignment of securitised exposures to grades or pools is of particular concern when using proxy data. Indeed, in accordance with Article 171(2) of Regulation (EU) No 575/2013, the less information an institution has, the more conservative its assignment of exposures to obligor and facility grades or pools needs to be. This is even more relevant in the case where the definition of default used in external data corresponding to the securitised exposures and proxy data is different from the definition used by the institution calculating K<sub>IRB</sub> in its internal model. Therefore, it is necessary for this Regulation to establish rules regarding the adjustments to be made and the margin of conservatism to be adopted in the estimation of the risk parameters in the context of calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013, where the definition of default used in external data corresponding to the securitised exposures or proxy data is different from the definition used by the institution calculating K<sub>IRB</sub> in its internal model.
- (15) This Regulation provides a sufficient degree of flexibility by not precluding institutions calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 from splitting the securitised exposures in sub-pools in order to calculate K<sub>IRB</sub> separately, as long as each sub-pool meets the corresponding provisions set out in Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013 and in this Regulation (i.e. exposures serviced by the institution calculating K<sub>IRB</sub>, exposures not serviced by the institution calculating K<sub>IRB</sub> using the retail risk quantification standards or the corporate risk quantification standards). Apart from that, as a consequence of what is set out in Article 258 of Regulation (EU) No 575/2013, 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<sub>IRB</sub> in accordance with this Regulation, in which case the K<sub>SA</sub> of those exposures shall be taken into account in the way foreseen in Article 259(7) of Regulation (EU) No 575/2013.
- (16) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (17) The EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>4</sup>.

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<sup>4</sup> 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 (OJ L 331, 15.12.2010, p. 12).

HAS ADOPTED THIS REGULATION:

*Article 1*

*Definitions*

1. For the purposes of this Regulation, the following definitions shall apply:

- (a) ‘calibration segment’ means a uniquely identified subset of the scope of application of the PD or LGD model that is jointly calibrated;
- (b) ‘PD model’ means all data and methods used as part of a rating system within the meaning of Article 142(1) point (1) of Regulation (EU) No 575/2013, which relate to the differentiation and quantification of own estimates of PD and which are used to assess the default risk for each obligor or exposure covered by that model;
- (c) ‘LGD model’ means all data and methods used as part of a rating system within the meaning of Article 142(1) point (1) of Regulation (EU) No 575/2013, which relate to the differentiation and quantification of own estimates of LGD, LGD in-default and ELBE and which are used to assess the level of loss in the case of default for each facility covered by that model.

*Article 2*

*Prior approval of using models to calculate K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013*

In order to calculate K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013, the permission of the competent authorities referred to in Article 143 of that Regulation shall be granted only where the competent authority is satisfied that all of the following conditions are met:

- (a) that the range of application of each of the models for calculating K<sub>IRB</sub> only includes securitised exposures in relation to which the institution calculating K<sub>IRB</sub> is not a servicer;
- (b) that all requirements of Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013 relating to rating systems are met, except those referred to in point (c). For such requirements, references in that Regulation shall be understood in the following sense for the purposes of their application in the context of this Regulation:

- (i) ‘seller’ shall be understood to refer to the originator of the securitisation transaction;
  - (ii) ‘purchasing institution’ shall be understood to refer to the institution calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013;
  - (iii) ‘institution’s exposures and standards’ as referred to in Article 179(1)(d) of that Regulation shall be understood as references to securitised exposures and standards applied to those exposures;
  - (iv) ‘type of exposures’ as referred to in Article 142(1)(2) of that Regulation shall be understood as references to securitised exposures which would have been considered as type of exposures if they had been managed by the institution calculating K<sub>IRB</sub> .
- (c) that the requirements of Articles 3 to 9 are met with regard to the application of the purchased receivable rules of that Regulation in the particular context of securitisation, instead of the corresponding ones in that Regulation, as set out in each of those Articles.

#### **Explanatory text for consultation purposes**

To cater for the different risk factors (including the underwriting standards and customer heterogeneity of the seller) and different overall management of the exposures, and in order to avoid that these elements as well as the external and proxy data used in relation to the securitised exposures do not affect the performance of rating systems used on exposures that the institution services:

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?

### *Article 3*

#### *Prior experience when calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013*

Instead of the requirements of Article 145 of Regulation (EU) No 575/2013, where an institution has received a permission to apply the IRB approach for at least one rating system within the

exposure class to which the securitised exposures are assigned, the experience required for that permission shall be considered sufficient prior experience for the purposes of this Regulation.

#### *Article 4*

##### *General conditions on risk quantification, credit policy and due diligence*

1. Institutions shall comply with the requirements specified in paragraphs 2 to 7, instead of Article 184 of Regulation (EU) No 575/2013.
2. In quantifying risk parameters to be associated with rating grades or pools for exposures meeting the conditions set out in point (a) of Article 2(2), institutions calculating  $K_{IRB}$  for the purposes of this Regulation shall ensure, on their own or through a party to the securitisation acting for and in the interest of the investors in the securitisation in accordance with the terms of the related securitisation documents, that all of the following requirements are met:

(a) that the structure of the securitisation ensures that under all foreseeable circumstances the SSPE has effective ownership and control of all cash remittances from the securitised exposures; that when the obligor makes payments directly to an originator or servicer, the institution calculating  $K_{IRB}$  has procedures to verify regularly that payments are forwarded completely and within the contractually agreed terms; and that the structure of the securitisation ensures that ownership over the securitised exposures and cash receipts is protected against bankruptcy stays or legal challenges that could materially delay the SSPE's ability to liquidate or assign the securitised exposures or retain control over cash receipts;

(b) that the institution monitors both the quality of the securitised exposures and the financial condition of the originator and servicer, including all of the following:

- (i) that the institution assesses the correlation among the quality of the securitised exposures and the financial condition of both the originator and servicer, and has in place internal policies and procedures that provide adequate safeguards to protect against any contingencies, including the assignment of an internal risk rating for the originator and servicer;
- (ii) that the institution has clear and effective policies and procedures for determining originator and servicer eligibility; that the institution or its agent conducts periodic reviews of originators and servicers in order to verify the accuracy of reports from the originator or servicer, detect fraud or operational weaknesses, and verify the quality of the originator's credit policies and servicer's collection policies and procedures; and that the findings of these reviews are documented;
- (iii) that the institution assesses:

- the characteristics of the securitised exposures pools, including over-advances;
  - the history of the originator's arrears, bad debts, and bad debt allowances;
  - the payment terms, and potential contra accounts;
- (iv) that the institution has effective policies and procedures for monitoring, on an aggregate basis, single-obligor concentrations both within and across pools of securitised exposures;
- (v) that the institution ensures that it receives from the originator or servicer, as applicable, timely and sufficiently detailed reports of securitised exposures' ageings and dilutions to ensure compliance with the securitisation's eligibility criteria and advancing policies governing securitised exposures, and providing an effective means with which to monitor and confirm the originator's terms of sale and dilution.
- (d) that the institution has systems and procedures for detecting deteriorations in the originator's financial condition and the securitised exposures' quality at an early stage and for addressing emerging problems pro-actively and, in particular, that the institution has clear and effective policies, procedures, and information systems to monitor covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problematic securitised exposures;
- (e) that the institution has clear and effective policies and procedures governing the control of securitised exposures, credit, and cash and, in particular, that written internal policies specify all material elements of the securitisation, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and the way cash receipts are to be handled; that these elements take appropriate account of all relevant and material factors, including the originator's and servicer's financial condition, risk concentrations, and trends in the quality of the securitised exposures and the originator's customer base; and that internal systems ensure that funds are advanced only against specified supporting collateral and documentation;
- (f) that the institution has an effective internal process for assessing compliance with all internal policies and procedures, including regular audits of all critical phases of the securitisation, verification of the separation of duties between, firstly, the assessment of the originator and servicer and the assessment of the obligors, and secondly, between the assessment of the originator and servicer and the field audit of the originator and servicer, as well as evaluations of back office operations, including qualifications, experience, staffing levels, and supporting automation systems.

**Explanatory text for consultation purposes**

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<sub>IRB</sub>?

## *Article 5*

### *General conditions for risk differentiation*

When assigning exposures to grades or pools, institutions shall consider the originator's underwriting standards and the servicer's recovery practices and servicing standards 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.

## *Article 6*

### *Eligibility for the retail treatment of non-retail securitised exposures*

1. For the purposes of this Regulation, in order for non-retail securitised pools to be eligible for the risk quantification standards for retail exposures as set out in Section 6, Chapter 3 of Title II, Part Three of Regulation (EU) No 575/2013, both of the following requirements shall be met instead of Article 153(6) of that Regulation:
  - (a) the non-retail securitised exposures shall comply with the requirements of paragraph 2, instead of the requirements referred to in points (a) to (d) of Article 154(5) of Regulation (EU) No 575/2013;
  - (b) it would be unduly burdensome for an institution to use the risk quantification standards for corporate exposures as set out in Section 6, Chapter 3 of Title II, Part Three of Regulation (EU) No 575/2013 for these exposures.
2. For the purposes of point (a) of paragraph 1, the following conditions shall be met:
  - (a) the SSPE shall have purchased the securitised exposures from unrelated third party originators to the institution calculating K<sub>IRB</sub>, and its exposure to the obligors in the pool of securitised exposures shall not include any exposures that are directly or indirectly originated by the institution calculating K<sub>IRB</sub> itself;
  - (b) the securitised exposures shall have been generated on an arm's-length basis between the originator and the obligor and as a result shall exclude inter-company accounts receivables and receivables subject to contra-accounts between firms that buy and sell to each other;

- (c) the SSPE shall have a claim on all proceeds from the securitised exposures or a pro-rata interest in the proceeds;
- (d) the pool of securitised exposures shall be sufficiently diversified.

3. For the purposes of point (b) of paragraph 1, the assessment of whether the use of risk quantification standards for corporate exposures is unduly burdensome for non-retail securitised exposures shall be carried out on the basis of the following considerations in a holistic manner:

- (a) the cost to the institution calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 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, including the cost of developing a non-retail internal model for calculating K<sub>IRB</sub> or the cost of integrating a new calibration segment into an existing one, as well as the cost of integrating the data into the institution's existing risk and reporting systems;
- (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, which shall be deemed to be the case 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. For the purposes of this calculation, loans or leases to a group of connected clients shall be considered as exposures to a single obligor;
- (e) the size and frequency of securitisation exposures within the institution where the application of the corporate risk quantification standards is considered unduly burdensome is not considered to be a material risk to the institution.

## *Article 7*

### *Eligibility for the retail treatment of retail securitised exposures*

For the purposes of this Regulation, in order for retail exposures to be eligible for the risk quantification standards for retail exposures as set out in Section 6, Chapter 3 of Title II, Part Three of Regulation (EU) No 575/2013, all of the following requirements shall be met instead of Article 154(5) of that Regulation:

- (a) the securitised exposures shall have been generated on an arm's-length basis between the originator and the obligor and as a result shall exclude inter-company accounts receivables and receivables subject to contra-accounts between firms that buy and sell to each other;

- (b) the SSPE shall have a claim on all proceeds from the securitised exposures or a pro-rata interest in the proceeds;
- (c) the pool of securitised exposures shall be sufficiently diversified.

### *Article 8*

#### *Calculation of risk-weighted exposure amounts for credit risk of securitised exposures*

1. In the case of retail securitised exposures that meet the requirements set out in Article 7, institutions calculating K<sub>IRB</sub> for the purposes of this Regulation shall calculate risk-weighted exposure amounts for credit risk in accordance with Articles 154 and, where applicable, Article 156 (b) of Regulation (EU) No 575/2013.
2. In order to calculate K<sub>IRB</sub> for non-retail securitised exposures, institutions shall, 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 and, where applicable, Article 156 (b) of Regulation (EU) No 575/2013.

### *Article 9*

#### *Requirements on data*

1. Where the securitised exposures and the obligors of those exposures were, before the transfer of such exposures to the SSPE, not obligors or exposures of the institution calculating K<sub>IRB</sub>, instead of the requirement of representativeness of the data used for model development in accordance with Article 174(c) of Regulation (EU) No 575/2013, the representativeness of the data shall be assessed in relation to the securitised exposures.
2. Instead of the requirement in the first sentence of Article 180(2)(c) of Regulation (EU) No 575/2013, institutions shall regard data related to the securitised exposures as the primary source of information for estimating loss characteristics.

### *Article 10*

#### *Use of proxy data*

1. Proxy data can be internal, external or pooled data in the sense of Regulation (EU) 575/2013.

The requirements of Article 179(1)(f) of Regulation (EU) No 575/2013 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 K<sub>IRB</sub>.

**Explanatory text for consultation purposes**

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

*Article 11*

*Use of data that is not itself consistent with the definition of default in accordance with Article 178(1) of Regulation (EU) No 575/2013*

1. The calibration of risk parameters shall be based on the institution's definition of default that is applicable to the respective internal model for calculating  $K_{IRB}$  in accordance with Article 255(4) of Regulation (EU) No 575/2013. Institutions calculating  $K_{IRB}$  for the purposes of this Regulation, which use external data or proxy data for the purpose of calibration of risk parameters shall meet all of the following requirements:

- (a) they shall ensure that the definition of default used in the external data or proxy data is consistent with Article 178 of Regulation (EU) 575/2013;
- (b) they shall ensure that the definition of default used in external data or proxy data is consistent with the definition of default as implemented by the institution calculating  $K_{IRB}$  in accordance with Article 255(4) of Regulation (EU) No 575/2013 for the relevant portfolio of securitised exposures, including: the counting and number of days past due that triggers default, the structure and level of materiality threshold for past due credit obligations, the definition of distressed restructuring that triggers default, the type and level of specific credit risk adjustments that triggers default and the criteria to return to non-defaulted status;
- (c) they shall document sources of external data or proxy data, the default definition used in these data, the analysis performed and all identified differences.

2. For each of the differences identified in the definition of default resulting from the assessment referred to in paragraph 1, institutions calculating  $K_{IRB}$  for the purposes of this Regulation shall meet both of the following requirements:

- (a) they shall assess whether the adjustment to the internal definition of default would lead to an increased or a decreased default rate or whether it is impossible to determine;
- (b) depending on the outcome of the assessment referred to in point (a), they shall either perform appropriate adjustments in the external data or proxy data or be able to demonstrate that the difference is negligible in terms of the impact on all risk parameters and own funds requirements, as appropriate.

3. With regard to the totality of the differences identified in the definition of default resulting from the assessment referred to in paragraph 1 and taking into account the adjustments performed in accordance with point (b) of paragraph 2, a broad equivalence with the internal definition of default used within the internal model for calculating K<sub>IRB</sub> in accordance with Article 255(4) of Regulation (EU) No 575/2013 has been achieved, including, where possible, by comparing the default rate in internal data on a relevant type of exposures with external or proxy data.

4. Where the assessment referred to in paragraph 1 identifies differences in the definition of default which are non-negligible but not possible to overcome by adjustments in the data, institutions calculating K<sub>IRB</sub> for the purposes of this Regulation shall adopt an appropriate margin of conservatism in the estimation of risk parameters in accordance with Article 179(1)(f) of Regulation (EU) No 575/2013. In that case institutions calculating K<sub>IRB</sub> for the purposes of this Regulation shall ensure that this additional margin of conservatism reflects the materiality of the remaining differences in the definition of default and their possible impact on all risk parameters.

#### *Article 12*

#### *Final Provision*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

#### **Explanatory text for consultation purposes**

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?

Done at Brussels,

*For the Commission  
The President*

*[For the Commission  
On behalf of the President*

*[Position]*



# Accompanying documents

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## Draft cost-benefit analysis / impact assessment

1. Article 255(4) of Regulation (EU) No 575/2013 (the CRR hereafter), as amended by Regulation (EU) 2017/2401 (the Regulation amending CRR hereafter) establishes that institutions may calculate  $K_{IRB}$  in relation to the securitised exposures in accordance with the provisions set out in Chapter 3 for the calculation of capital requirements for purchased receivables.
2. Article 255 (9) establishes that the EBA shall develop draft regulatory standards to specify in greater detail the conditions to allow institutions to calculate  $K_{IRB}$  for the underlying pools of securitisation in accordance with paragraph 4.
3. The EBA shall submit those draft regulatory technical standards to the Commission by 18 January 2019. Current draft RTS is the EBAs's response to the mentioned mandate.
4. As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any RTS developed by the EBA shall be accompanied by an Impact Assessment (IA) annexe which analyses 'the potential related costs and benefits' before submitting to the European Commission. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts'.
5. For the purposes of the IA section of the Consultation Paper, the EBA prepared the IA with a cost-benefit analysis of the policy options included in the regulatory technical standards described in this Consultation Paper. Given the nature of the study, the IA is high-level and qualitative in nature including some quantitative analysis when possible.

### A . Problem identification

6. The Regulation amending CRR introduce in the European Union three new approaches to the calculation of capital requirements on securitisation positions, SEC-IRBA, SEC-SA and SEC-ERBA, in accordance with the July 2014 revision of the Basel securitisation framework. SEC-IRBA and SEC-SA are formulae-based approaches that require, among other inputs, the capital requirement on the exposures underlying the securitisation transaction. SEC-ERBA is based on external ratings and does not depend on the capital requirement of the securitised exposures.

7. The Regulation amending CRR attempts to substantially reduce reliance on external ratings within the securitisation framework. It places the approach based on internal models (SEC-IRBA) to the top of the hierarchy, and places SEC-SA and SEC-ERBA as, respectively, second and third approach, unless specific conditions for the inversion of this hierarchy are verified, in which case SEC-ERBA may be used secondly.
8. However, the use of SEC-IRBA, which relies on the possibility for the institution to be able to apply the general IRB credit risk framework and calculate the IRB capital requirements of the underlying pool of securitised exposures, would be generally limited to IRB originating institutions that service those securitised exposures because they have full access to the necessary information on them. IRB investing institutions would not generally be able to apply the SEC-IRBA due to the lack of sufficient information on the underlying pool and, consequently, the most risk sensitive approach would have limited use.

## B. Policy objectives

9. The main objective of the RTS is to specify the conditions to allow institutions to calculate K<sub>IRB</sub> for the underlying pools of a securitisation in accordance with the provisions set out in Chapter 3 of CRR for the calculation of capital requirements for purchased receivables. This would allow institutions that do not service the securitised exposures and that hold a securitisation position to apply the SEC-IRBA and facilitate the achievement of the general objective of reducing reliance on external ratings within the securitisation framework.
10. As a result, the specific objective of the RTS is to specify in greater detail, when using the existing provisions on purchased receivables in the CRR, the following:
  - a) the internal credit policy and models for calculating K<sub>IRB</sub> for securitisations;
  - b) the use of proxy data to estimate PD and LGD, where sufficient accurate or reliable data on the underlying pool is not available, and
  - c) due diligence requirements to monitor the actions and policies of original lenders, services and, where applicable, originators.

## C. Cost-Benefit Analysis

11. Taking into account the foregoing, the proposed technical standards are expected to provide enough benefits for institutions and supervisors that more than offset the additional costs connected with their implementation.
12. From the perspective of an institution calculating K<sub>IRB</sub>, the benefit is that the SEC-IRBA, which sits at the top of the hierarchy, has been calibrated to generally produce lower capital requirements, as it is the most risk sensitive approach, which implies an increased capacity to lend and invest for a given capital base, with the limit imposed by the leverage ratio. This



most likely more than offsets the additional costs connected with the development and approval of new internal rating systems for securitised exposures and the internal governance requirements imposed as a consequence.

13. From the perspective of supervisors, the increased costs of supervision that a more extended use of internal rating systems involve, in comparison with simpler rating based approaches, would be offset by the benefits arising from further reducing the reliance on external ratings in the regulatory capital framework, which will mitigate in the future the negative impact of the herding and cliff effects that arose in the financial crisis from credit rating agencies rating thresholds being hard-wired into laws, by reducing the mechanistic reliance by market participants and establishing stronger internal credit risk assessment practices instead.
14. Regarding those negative impacts, it is relevant to note, as the Basel Committee underlined, that: ‘during the crisis, credit rating agencies (CRAs) downgraded the ratings of many securitisation tranches, including senior tranches, highlighting deficiencies in credit rating agency models originally used to determine the ratings. .... Recognising that their models had been inadequate, shortly after the crisis CRAs began to make fundamental changes to their methodologies. ... As rating agencies downgraded highly-rated securitisation exposures below investment grade, regulatory capital requirements increased rapidly and significantly due to the presence of cliff effects within the securitisation framework. Market uncertainty and procyclical cliff effects in capital requirements created incentives for banks in certain jurisdictions to sell securitisation exposures to maintain their capital ratios. This in turn further depressed values leading to mark-to-market losses in fair valued portfolios’.

## Overview of questions for consultation

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?

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  $K_{IRB}$ ?

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

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?