Association for Financial Markets in Europe

Consultation Response

PRA CP13/24 – Remainder of CRR: Restatement of assimilated law

15 January 2025

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the PRA Consultation Paper CP13/24 – Remainder of CRR: Restatement of assimilated law (**CP13/24**). CP 13/24 builds on the PRA Discussion Paper 3/23 on securitisation capital requirements (**DP 3/23**), and we reference our response to that discussion paper (**Our Response to DP3/23**).

In addition to the views and recommendations shared with respect to Chapter 3 on the securitisation requirements, we would like to provide some comments on the remaining parts of the CP. Primarily, our feedback relates to the definition of Institutions under Article 119(5) (Chapter 6 of the CP) and the mapping of external credit rating agency ratings to credit quality steps (Chapter 7 of the CP). In addition, there are several regulatory items that, if left unresolved in their current form, could contribute to an uneven playing field for UK banks when compared to their counterparts headquartered in other jurisdictions, and with no material benefits to the PRA's primary objective. We recommend a review of 1) Tier 2 add-ons: general provisions and 2) the minority interest calculation.

Responses to consultation proposals

Chapter 3: Securitisation requirements

Proposal 1: *A formulaic p-factor for the securitisation standardised approach (SEC-SA)*

We warmly welcome the PRA's recognition of, and proposal to address, the Output Floor Issue (as well as to address, to a certain extent, the excessive level of non-neutrality present in the SEC-SA), including the greater proposed quantum of reduction in the SEC-SA p-factor. It is AFME's intention to provide confirmatory quantitative analysis following on from this consultation response, especially for STS transactions.

We welcome the PRA's recognition of, and proposal to address: (i) the threat to securitisation, generally, and significant risk transfer (**SRT**) securitisation, in particular, described in detail in Our Response to DP3/23 (the **Output Floor Issue**), resulting from the disproportionate impact on securitisations, compared with other non-securitised exposures, of the CRR 3.1 output floor[1]; and (ii) (to a certain extent) the excessive level of non-neutrality present in the SEC-SA[2], where risk weights are disproportionately higher than those that apply under the SEC-IRBA in a way that is not justified by, or proportionate to, the associated risk[3].

[1] Making it difficult for bank originators to achieve a viable cost of capital for their securitisations, or to release capital at all for certain asset classes.
[2] See 3.12 of CP 13/24.
[3] See 3.12 and 3.22 of CP 13/24.

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In particular, we welcome the PRA's recognition of our evidence-based concern[4] that a reduction in the SEC-SA p-factor to the 0.7 value referred to in DP 3/23[5] would not result in economically viable SRT securitisations in the asset classes otherwise impacted by the Output Floor Issue, so would not resolve the issues identified.

In CP 13/24, the PRA proposes an alternative approach to the p-factor calculation under the SEC-SA (the **PRA's CP 13/24 SEC-SA Risk Sensitive P-Factor Proposal**). Under this approach - which is closely based on the existing SEC-IRBA p-factor – p can be reduced to 0.5 for transactions that do not qualify as simple, transparent and standardised (**STS**) securitisations and to 0.3 for STS transactions (and caps out at the p-factor otherwise applicable under the SEC-IRBA). The actual reduction, however, is based on a formula which depends on multiple transaction features including portfolio granularity and loss given default (**LGD**), tranche maturity and seniority, and whether or not the deal is retail, meaning that the theoretical lowest p-factor value may not be achieved in practice for a tranche.

In Our Response to DP3/23, we noted, based on data for real-world non-STS transactions, that a flat p-factor of 0.5 would be expected to reduce the increase in the weighted average risk weights resulting from the output floor to approximately +1%-+16%, with increases mostly in the +5%-+15% range, and bring the increase in cost of capital flowing from application of the output floor down to 1.1x to 1.4x the SEC-IRBA cost of capital. This was slightly greater than the output floor related change in risk weights for the *underlying assets* of the same real world securitisations (i.e. the change in the assets' risk weights prior to securitisation), where the change was in the range approximately -6% (i.e. a 6% reduction in risk weight) to +10%, but an enormous improvement on the wholly disproportionate increases in weighted average risk weights resulting from implementation of the output floor 'as is': an absolute c30% - 50% increase in the weighted average risk weight of originator-retained tranches[6], with increases mostly in the 40% - 50% range.

We have now analysed the PRA's CP 13/24 SEC-SA Risk Sensitive P-Factor Proposal for non-STS transactions. Preliminary findings indicate that the majority of existing transactions would meet the conditions to benefit from the 0.5 floor for non-STS transactions embedded in the PRA's CP 13/24 SEC-SA Risk Sensitive P-Factor Proposal and that the conclusions of the data provided in Our Response to DP3/23 for real-world non-STS transactions (recapped above) therefore stand in relation to that proposal.

Given that the Output Floor issue is of greatest importance to SRT securitisations and the UK SRT market is, at present, overwhelmingly synthetic and hence, in a UK context, non-STS, the data in Our Response to DP3/23 focussed on non-STS SRT transactions. We have, however, now also analysed the PRA's CP 13/24 SEC-SA Risk Sensitive P-Factor Proposal for STS (traditional) transactions. It is AFME's intention to provide confirmatory quantitative analysis following on from this consultation response for both STS and non-STS transactions.

In relation to the proposed optionality of the new mechanic, we would be grateful for confirmation that this applies on a per transaction basis and that there is no obligation on, or expectation for, firms to apply the more conservative of the two approaches.

We note that the PRA's CP 13/24 SEC-SA Risk Sensitive P-Factor Proposal is articulated as an optional alternative to the current SEC-SA p factor calculation. We would be grateful for confirmation / clarification that there is no obligation on, or expectation for, firms to apply the more conservative of the two approaches

[4] See the data in Our Response to DP3/23 for example pp3-4 and Annex 1A.

[5] The PRA referred to this as the level to which there is "scope for reducing the p factor" without falling below the SEC-IRBA p factor in "most" securitisations of "non-retail exposures", presumably meaning non-STS transactions, given that the p factor for STS transactions (including STS SRT traditional securitisations, and – in theory – synthetic SRT transactions qualifying for an STS equivalent prudential benefit under Article 270 CRR) is already set at 0.5.

[6] Across all retained tranches, including the first loss tranche where applicable.

(which would generally preclude use of PRA's CP 13/24 SEC-SA Risk Sensitive P-Factor Proposal). Provided that the proposed optionality does not, in practice, ever preclude use of PRA's CP 13/24 SEC-SA Risk Sensitive P-Factor Proposal, the optionality may be of assistance in, for example, cases where the operational burden of implementation is not justified by the benefits. It is apparent from CP 13/24, that the proposed optionality is intended to apply on a per transaction basis[7]. However, this is not explicit in proposed Article 261, and we would be grateful if this could be clarified.

The following section flags key developments in 2024 in relation to securitisation, in the EU and US, in order to emphasize momentum for change and in doing so, highlighting potential vulnerability for the UK in relation to global competitiveness:

- ***Since Our Response to DP3/23, growth in the EU securitisation market - including through prudential reform - has been placed at the top of the agenda for capital markets union reform in the EU, with policymakers recognising its potential to facilitate (amongst other things) lending to the real economy and assist with the green transition and digital transformation. In this context, and as a basis for potential legislative proposals, the European Commission has launched a wide-ranging consultation to assess the factors hampering the development of the market, including the prudential treatment of securitisation for banks and insurers.***

    - Enrico Letta, in his report on the European single market, published April 2024[8], for example, identified an objective "*by 2025, to revise the securitisation framework to simplify the utilisation of this instrument, crucial for diversifying asset investment and releasing banks' balance sheet capacity. This, in turn, will enable banks to offer additional financing*".

    - The Expert Committee on Developing European Capital Markets to Finance the Future (chaired by Christian Noyer), in its April 2024 report[9], noted that *"[a]n increasingly broad political consensus is emerging on the pivotal role of securitisation as a tool for financing the European economy. The decline in the European securitisation market is largely due to regulatory and prudential factors… The first priority is to quickly adjust the regulatory and prudential framework for securitisation…*".

    - The ECB's governing Council on advancing the capital markets union indicated, on 7 March 2024[10], that "*key initiatives in the CMU action plan to achieve priority*" included "*ensuring that the EU securitisation market can play a role in transferring risks away from banks to enable them to provide more financing to the economy, while creating opportunities for capital markets and investors. This requires understanding the supply and demand factors relevant for the development of the characterisation market, including … reviewing the prudential treatment of securitisation for banks and insurance companies and the reporting in due diligence requirements while taking into account international standards…*".

    - As a basis for potential legislative proposals, the European Commission has launched a consultation[11] (the **EU Commission Consultation**) to assess the supply and demand factors hampering the

[7]See paragraph 3.1 to P 13/24, which indicates that the choice is made "for each securitisation".
[8] https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf.
[9] https://www.tresor.economie.gouv.fr/Articles/e3283a8f-69de-46c2-9b8a-4b8836394798/files/9669bf72-f9f6-4a09-87c7-119d2b366be2
[10] https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.pr240307~76c2ab2747.en.html.
[11] Targeted Consultation on the Functioning of the Securitisation Framework: https://finance.ec.europa.eu/document/download/fb451cdc-4e5b-4d74-9411-cb8bd0789090_en?filename=2024-eu-securitisation-framework-consultation-document_en.pdf.

development of the securitisation market in the EU, including the prudential treatment of securitisation for banks and insurers (as well as transparency and due diligence requirements).

- ***Since Our Response to DP3/23, the outcome of the US presidential election (following widespread and relatively bipartisan rejection of the proposals to implement Basel 3.1 in the US) casts doubt on the prospects of these reforms being implemented in the US in any form (including the securitisation reforms implemented in the EU and UK in 2019). US banks subject to Basel based rules therefore remain subject to a p factor of 0.5. Agency MBS, in any case, offers securitisation benefits unrestricted by the Basel securitisation prudential rules.***

We note that the US continues to apply the securitisation capital requirements that preceded the reforms introduced in the EU in 2019, and hence a p factor of 0.5 under the standardized approach, giving its banks a competitive edge over the EU. While the original US Basel 3.1 implementation proposals would have brought the jurisdiction in line with the EU in relation to the standardized p-factor, it has been clear since September 2024, that the US Basel 3.1 reforms will not be implemented without comprehensive re-proposal[12], and the outcome of the recent US presidential election, indeed, casts doubt on the prospects of their being implemented in *any* form.

The existence of government-guaranteed MBS in the US, in any case, offers the benefits of securitisation for originators and real economy unrestricted by the Basel securitisation prudential rules. In recent years, agency MBS has represented around 90% and 80% of total MBS outstanding in the US and Canada respectively[13].

We welcome the PRA's recognition, in CP 13/24, that there is insufficient risk sensitivity within the securitisation prudential framework, specifically in relation to the level of p within the SEC SA formula and in relation to the current formulation of the securitisation risk weight floor. We would be grateful if the PRA could monitor the progress of proposals in the EU emerging from EU Commission Consultation - in particular, developments relating to the securitisation risk-weight floor - and, if they gain traction, consider whether the reform might also have a place in UK domestic regulation.

AFME welcomes the PRA's recognition in CP 13/24, that there is insufficient risk sensitivity within the securitisation prudential framework, specifically in relation to the level of p within the SEC SA formula (see 3.12, 3.15 and 3.17 of CP 13/24) and in relation to the current formulation of the securitisation risk weight floor (see paragraph 3.19 of CP 13/24).

We appreciate the challenges faced by the PRA in triangulating its primary objective of promoting the safety and soundness of UK firms with its (two-fold) secondary objective of, so far as reasonably possible, facilitating the international competitiveness of the economy of the UK and its growth in the medium to long term while aligning with relevant international standards.

The challenge associated with the PRA's secondary objective is heightened (as evidenced above) by a rapidly evolving regulatory and prudential landscape, in both the EU and US, which potentially jeopardizes the UK's competitiveness on the global stage.

The PRA has, within CP13/24, evidently (and appropriately in light of the two-fold nature of its secondary objective), considered the scale of deviation from the Basel standards in both absolute terms and relative to other jurisdictions. While the scale of deviation in absolute terms is a constant, this is not the case on a relative basis, highlighting the importance of using the UK's agile regulatory regime to adapt, in short order, to maintain a competitive advantage without compromising its primary objective.

As the PRA acknowledges, refinements to the prudential framework to enhance risk sensitivity[14] can, importantly, also enhance the safety and soundness of UK firms, while supporting UK competitiveness. The importance of strict alignment with relevant international standards must, we feel, be diminished where such strict compliance is likely to be unilateral.

We would therefore be grateful if the PRA could monitor the progress of any proposals in the EU and, if they gain traction, consider whether the reform might also have a place in UK domestic regulation.

A case in point regarding jurisdictional deviation from Basel standards may apply in the near future in the EU in relation to the securitisation risk weight floor. While we recognize that adjustments to securitisation risk weight floor is not within scope of CP13/24, AFME believes that this is an important component of the "risk sensitivity" debate.

Rather than offering concrete proposals, the EU Commission Consultation asks wide ranging questions in order to ascertain impediments, including prudential impediments, to growth in the securitisation market. In so far as concrete prudential reform proposals are mentioned, these include the proposed reductions in the risk weight floor (12% for non-STS deals; 7% for SEC-IRBA STS deals; 10% for STS deals on other approaches) mooted by the EU ESAs in their December 2022 report (the EU ESAs' Securitisation Report) and the possible extension of the transitional halving of the SEC-SA p-factor within the output floor, to the SEC-SA as a whole on a permanent basis.

The Commission is, however, reviewing various alternatives, contributed by parties both within the official sector and private sector.

Within AFME's Commission Consultation response, it has proposed restoration of the securitisation risk weight floor commensurate to pre-2019 EU Securitisation Regulation levels at 7% and 12%, for STS and non STS respectively for all types of securitisation transactions as a simple solution which goes some way to mitigating excessive capital non neutrality that exists across the capital structure.

Other solutions, which are more risk sensitive but perhaps also more complex for parties less familiar with the securitisation product, include for example introduction of a risk sensitive risk weight floor[15]. These responses articulate the view that the risk weight floor, applicable under all securitisation risk weighting approaches, is a key contributor to the overall non-neutrality of the securitisation risk weighting framework. That, on its current, non-risk sensitive calibration, it (economically) discriminates against, and prevents the securitisation of, lower risk weight asset classes, such as RMBS, to achieve SRT, thereby reducing the product's utility as an efficient tool to redistribute risks of those assets enabling banks to redeploy funding and capital to areas that contribute more to GDP growth.

Restating comments made in response to DP 3/23, but noting recent developments suggesting that a comprehensive review of the securitisation prudential requirements is not on the BCBS's agenda, we

[14] See 3.22-3.24 of CP13/24.

[15] This proposal and its calibration, which are raised in responses by, in particular, IACPM and Paris Europlace, are discussed in detail in the May 2024 Risk Control publication "Rethinking the Securitisation Risk Weight Floor" https://www.riskcontrollimited.com/wp-content/uploads/2024/05/20240503-Rethinking-the-Securitisation-Risk-Weight-Floor-v61.pdf.

suggest that, given the very lengthy timeframe associated with Basel reform, significant differences between national and regional markets, and the potential benefits to the UK economy at a time of challenge, the UK should proceed with domestic reforms.

In the fullness of time, an evaluation of the securitisation capital framework, by the BCBS, leading to greater risk sensitivity and reductions in the overall level of non-neutrality (i.e. the extent to which the aggregate capital requirements for the tranches in a securitisation exceed the capital requirement for the underlying assets), would be ideal. However, such a comprehensive review is not on the BCBS's agenda (see, for example, the FSB's July 2024 Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation) and, in any case, given the extremely lengthy timeframe likely to be involved in effecting change at Basel level and the potential benefits of the market to the UK economy at a time of challenge, AFME strongly supports domestic reforms now in the UK. While international standards are important, significant differences between national and regional markets should not be ignored and proportionate capital requirements sacrificed on this altar. This is particularly true given the dim prospects of implementation, at all, in the US and the likelihood of rationalising domestic reforms in the EU.

Restating comments made in response to DP 3/23, we note that risk sensitivity is a fundamental principle of prudential regulation – that the current lack of risk sensitivity in the securitisation framework disincentivises economic activity (securitisation and the lending to the real economy that depends on it) and creates an unlevel playing field between asset classes. The current calibration of the securitisation risk weighting formulae in the SEC-SA and SEC-IRBA also creates major disconnects between risk and capital requirements, particularly for tranches in the mezzanine range. That reforms resulting in more proportionate and risk sensitive capital requirements would reverse these issues.

Proportionality to risk / risk sensitivity of capital requirements is a fundamental principle of prudential regulation. There is a direct trade-off between capital requirements and economic activity/transaction viability, meaning that capital requirements should be imposed only to the extent required to guard against risks, based on the available data, and no further. Proportionality to risk / risk sensitivity of capital requirements is also essential in order to ensure a level playing field between asset classes, avoiding effective regulatory promotion of one business line/structure over another.

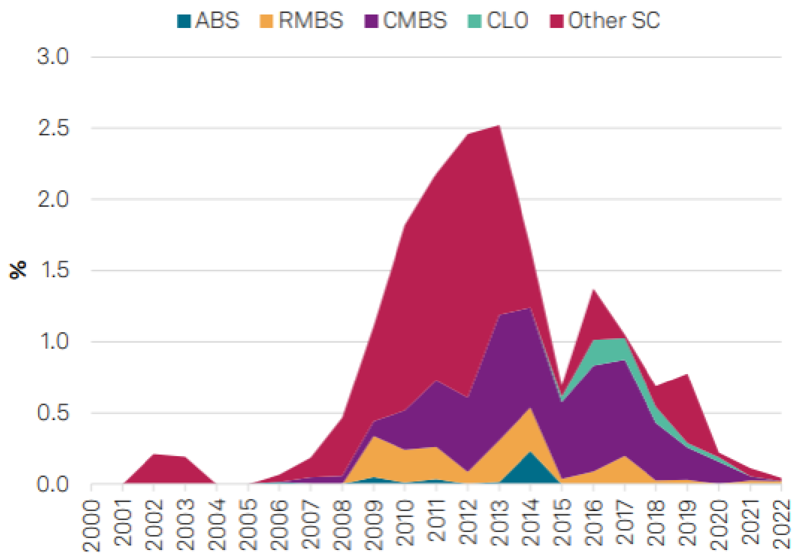
The current, in AFME's view, wholly disproportionate capital calibration for securitisation positions in the EU disincentivises economic activity (securitisation, and the underlying lending to the real economy that depends on it), which would otherwise be undertaken in a more risk-aligned prudential environment.

The current calibration of the securitisation risk weighting formulae in the SEC-SA and SEC-IRBA also creates major disconnects between risk and capital requirements, particularly for tranches in the mezzanine range.

Restating comments made in response to DP 3/23, we note that the current calibration of the securitisation risk weighting framework is wholly disproportionate to the inherent risks of the market in the UK.

The re-calibration of the Basel securitisation framework post- the global financial crisis (which as previously noted the US has, ironically, not yet implemented) was largely based on the experience of US sub-prime securitisations and failed to reflect the realities of UK and European securitisation performance, which remained strong even through the GFC:

Annual default rate, European sector contributions



SC--Structured credit. Source: S&P Global Market Intelligence CreditPro.

Of the defaults that have been observed in the UK and EU all are, the data indicate, associated with structures documented prior to the GFC (2004-2007): structural protections in post GFC transactions (such as prevailing levels of subordination) are much greater.

The data on which the re-calibration of the Basel securitisation framework was based, focused on US RMBS and pre-date the non-prudential securitisation reforms (in relation to risk retention, disclosure, due diligence, credit-granting, and re-securitisation) implemented since the GFC. The cumulative effect of Basel reforms since, and including, those implemented in the CRR in 2019 therefore now needs to be considered, in order to ensure that all banks that are engaged in the EU securitisation markets can expand their capacity to serve the UK market and the UK's role as a global financial centre.

In relation to policy proposals mooted in DP 3/23 in connection with the Output Floor Issue but not adopted in CP 13/24, we welcome the PRA's decision not to take forward changes to the securitisation hierarchy of methods.

We welcome the PRA's decision not to, at this point, take forward changes to the securitisation hierarchy of methods ((broadly) prioritising the SEC-ERBA over the SEC-SA. The impact on capital requirements of the contemplated change (which is mixed overall) would, for certain transaction types, have been adverse and unavoidable and have had meaningful negative implications in terms of trading and, as a result liquidity provision, in the market. The negative impact on trading and liquidity provision would have been an adverse outcome in terms of the PRA's safety and soundness objective.

In relation to policy proposals mooted in DP 3/23 in connection with the Output Floor Issue but not adopted in CP 13/24, we regret the PRA's decision not to extend STS treatment to synthetic securitisations.

We regret that the PRA remains of the view that extending the preferential capital treatment for STS securitisations currently set out in the Securitisation Chapter of the CRR to synthetic securitisations when replacing it with PRA rules would not, on the whole, advance its objectives. We continue to regard an STS regime for synthetic securitisations of all asset classes as desirable, offering benefits in terms of transaction standardisation, reduction in barriers to entry for new market participants, and, where associated with prudential benefits, increased volumes of risk transfer (with associated benefits to the real economy and banks' resilience).

Proposal 2: *A new capital treatment of retail residential mortgage loans under the Mortgage Guarantee Scheme (MGS) and private mortgage insurance schemes with similar contractual features to MGS*

The currently regulatory approach to MGS Guarantees And Private Sector Equivalent Schemes engages the adverse consequences of securitisation classification, while, arguably, ruling out - due to re-securitisation concerns - securitisation benefits in relation to the guaranteed assets: securitisation to obtain funding and/or liquidity and/or (in practice, due to the PRA's approach to commensurateness) prudential derecognition of the securitised assets and securitisation risk weighting. (Even the PRA's helpful alternative risk weighting proposals in relation to MGS Guarantees And Private Sector Equivalent Schemes – which do not require significant or commensurate risk transfer to be demonstrated - do not confer the benefits associated with transfer of risk on a "tranched" basis, prudentially.) The response below sets out, for consideration by the PRA, one possible alternative line of interpretation. This is intended to be without prejudice to any other arguments that may be advanced by Members and their advisers in relation to the application/relevance to MGS Guarantees And Private Sector Equivalent Schemes of the "securitisation" and "synthetic securitisation" definitions.

Identification of the guarantee provided in respect of retail residential mortgage loans under the Mortgage Guarantee Scheme (**MGS**), and private mortgage insurance schemes with similar contractual features to MGS (together, **MGS Guarantees And Private Sector Equivalent Schemes**) as giving rise to a synthetic securitisation, arguably prevents assets benefitting from MGS Guarantees And Private Sector Equivalent Schemes from being included in securitisations due to the potential for such securitisations to, in consequence, be classified, and prohibited, as re-securitisations[16]. This is a highly adverse consequence of HMT's well intentioned and welcome credit support, which is presumably intended to facilitate origination of these retail residential mortgage assets. The issue potentially limits a bank's ability to use the guaranteed assets to obtain funding, or as collateral for liquidity purposes. This consequence appears particularly disproportionate/erroneous in combination with banks' inability (in practice, due to the PRA's approach to commensurateness) to benefit from prudential recognition of MGS Guarantees And Private Sector Equivalent Schemes as securitisations (meaning that the originating bank cannot derecognise the assets prudentially via SRT and recognise the credit enhancement benefit of in terms of first loss protection provided by the guarantee in risk weighting its retained senior tranche). (Even the PRA's helpful alternative risk weighting proposals in relation to MGS Guarantees And Private Sector Equivalent Schemes – which do not require significant or commensurate risk transfer to be demonstrated - do not confer the benefits associated with "transfer of risk" on a "tranched" basis, prudentially (i.e. there is no prudential recognition of the first loss nature of the guarantee).) MGS Guarantees And Private Sector Equivalent Schemes therefore engage the adverse consequences of securitisation classification, while ruling out securitisation benefits in relation to the guaranteed assets: securitisation to obtain funding and/or liquidity and/or (in practice, due to the PRA's

[16] As defined in Article 2(4) of the Securitisation Regulation and Article 4(1)(63) CRR.

approach to commensurateness) prudential derecognition of the securitised assets and recognition of the benefits associated with transfer of risk on a "tranched" basis.

The analysis below suggests one possible alternative line of interpretation. Importantly, this analysis is intended to be without prejudice to, and not to undermine, any other lines of argument that may be advanced by Members and their advisers in relation to the application/relevance to MGS Guarantees And Private Sector Equivalent Schemes of the "securitisation" and "synthetic securitisation" definitions.

Interpreting the "transfer of risk" referred to in the "synthetic securitisation" definition as having a prudential meaning (a synthetic securitisation being a prudential risk transfer mechanism), in circumstances in which the beneficiary bank/protection purchaser does not elect to, or is unable to, recognise the MGS guarantee or private sector equivalent as prudential credit protection, and the protection provider is either not prudentially regulated, or recognises a full (rather than tranched) exposure to the protected exposure, the protection should not give rise to a synthetic securitisation, or securitisation. This principle can be observed to exist already (hopefully uncontroversially) in other contexts such as the non-securitisation treatment of first loss guarantees provided by parents in respect of their adult children's residential mortgage applications. We would welcome guidance to this effect.

The recognition of credit risk mitigation, including in a synthetic securitisation context, is as the PRA notes in its statement on the regulatory treatment of retail residential mortgage loans under the MGS[17], explicitly permissive (rather than mandatory) from the perspective of the beneficiary of the credit protection (see e.g. Article 193(3) CRR, 245 CRR and 247(2) of CRR).

A "synthetic securitisation" as defined in Article 242(14) of the CRR by reference to Article 2(10) of the Securitisation Regulation, is "a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator". If the "transfer of risk" referred to in this definition (the risk presumably being the "credit risk associated with an exposure or a pool of exposures" identified in the "securitisation" definition) is understood to have a prudential meaning (and a synthetic securitisation is a prudential risk transfer mechanism), the definition can be interpreted as engaged only where the "transfer of risk" is recognised, prudentially, by the protection buyer and/or the protection seller). A similar interpretation can be applied to the requirement to "hedge the credit risk of the portfolio" through the use of "funded (eg credit-linked notes) or unfunded (eg credit default swaps) credit derivatives or guarantees" in the "synthetic securitisation" definition at Basel level (i.e. that the hedging has to be prudentially effective to count)[18]. On that basis, in circumstances in which the protection purchaser does not elect to recognise the guarantee as prudential credit protection (and/or, in relation to a private sector equivalent to the MGS, the protection does not meet the CRR eligibility criteria applicable to guarantees, so is not recognisable as prudential credit protection) and the protection provider is either not prudentially regulated, or recognises a full (rather than tranched) exposure to the protected exposure, the protection would not give rise to a "synthetic securitisation" (neither, clearly, would it constitute a traditional securitisation[19]).

[17] https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/pra-statement-on-mortgage-guarantee-scheme
[18] Basel CRE 40.3 "A synthetic securitisation is a structure with at least two different stratified risk positions or tranches that reflect different degrees of credit risk where credit risk of an underlying pool of exposures is transferred, in whole or in part, *through the use of funded (eg credit-linked notes) or unfunded (eg credit default swaps) credit derivatives or guarantees that serve to hedge the credit risk of the portfolio*. Accordingly, the investors' potential risk is dependent upon the performance of the underlying pool".
[19] A "*traditional securitisation*" being "*a securitisation involving the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures from the originator to an SSPE or through sub-participation by an SSPE, where the securities issued do not represent payment obligations of the originator*".

Although the “securitisation” definition does not explicitly require a securitisation to be either a synthetic securitisation or a traditional securitisation, and schemes do exist that incorporate elements of both securitisation types, or neither, and positively seek securitisation characterisation (we would be happy to discuss this area in greater detail with the PRA), the requirements of Chapter 5 of the CRR and of the Securitisation Regulation are framed in binary terms (i.e. dividing securitisations between traditional and synthetic securitisations). It would appear unduly onerous to regard protection that does not give rise to a “synthetic securitisation”, or (clearly) a “traditional securitisation”, and does not seek securitisation prudential treatment, as engaging the “securitisation” definition, or the requirements of Chapter 5 of the CRR, or of the Securitisation Regulation.

Extending this interpretation of the phrase “transfer of risk” in the synthetic securitisation definition (i.e. that it has a prudential meaning) beyond MGS Guarantees And Private Sector Equivalent Schemes, examples can be provided that, we hope, indicate the appropriateness of the reading. The interpretation would, for example, be relevant (hopefully uncontroversially!) to first loss guarantees provided by parents in respect of their adult children’s residential mortgage applications (in this case, the protection provider is not prudentially regulated and the protection is ineligible as CRR credit risk mitigation due to the identity of the protection provider[20]). Another example would arise in relation to purchased receivables transactions between corporate sellers that are not prudentially regulated and purchasers that are either not prudentially regulated or do not recognise the benefit of the credit protection (e.g. a refundable purchase price discount or partial first loss guarantee) prudentially.

We would welcome guidance supporting the interpretation articulated above.

We also note that the MGS terms sit uneasily with synthetic securitisation characterisation in the sense that the guaranteed portion of the loan amortises before the non-guaranteed portion (in a way that would be bizarre for the first loss tranche in a synthetic securitisation), due to the guarantee being (very broadly) of the difference between the target effective LTV and the actual LTV (so that it reduces with loan repayment and LTV reduction).

The PRA’s alternative risk weighting proposals in relation to MGS Guarantees And Private Sector Equivalent Schemes – which we welcome - do not confer the benefits associated with “transfer of risk” on a “tranched” basis, prudentially (i.e. there is no prudential recognition of the first loss nature of the guarantee). Further interpreting the phrase “transfer of risk” in the synthetic securitisation definition (which, as indicated above, we think has a prudential meaning) in light of the “securitisation” definition requirement for “risk” to be “tranched”, MGS Guarantees And Private Sector Equivalent Schemes recognised in line with these proposals can therefore also be interpreted as not giving rise to synthetic securitisations, or securitisations, provided that the protection provider is also either (like HMT) not prudentially regulated, or recognises a full (rather than tranched) exposure to the protected exposure. We would welcome guidance to this effect. If the PRA is open to this approach, the terminology associated with the treatments (currently “qualifying securitisations”) could helpfully be amended (including to clarify that there is no need to be a securitisation in order to benefit).

We note that the PRA’s alternative prudential recognition proposals in relation to MGS Guarantees And Private Sector Equivalent Schemes, which we welcome, do not recognise, or confer the prudential benefits associated, with credit risk tranching (within the meaning of Article 4(1)(67) of the CRR and Article 2(6) of the

[20] Noting that credit protection on securitisation positions has to meet the requirements of Chapter 4 (Article 249 CRR).

Securitisation Regulation[21]). The PRA proposes to require standardised banks to apply the loan splitting approach (under the CRR 3.1 general credit risk standardised approach) to the guaranteed loan, reflecting the guaranteed portion of the loan (which is zero risk weighted where provided by HMT) as effectively the *top slice* of LTV. For IRB banks (the IRB approach to credit risk does not include the loan splitting approach to residential mortgages), the PRA instructs banks to treat the guarantee as a pro rata, rather than tranched first loss, credit protection. Recognition is conditional on certain parameters relating to the tranche[22]. There is thus no recognition of the first loss nature of the credit protection. The enhancements that we propose below to the approach for IRB banks, also do not involve prudential recognition of credit risk tranching, merely an LTV approach in LGD modelling.

Interpreting (as discussed above) the phrase "transfer of risk" in the synthetic securitisation definition as having a prudential meaning, and further interpreting the phrase in light of the requirement in the "securitisation" definition for "credit risk" to be "tranched": there is no prudential "transfer of risk" on a "tranched" basis, from the beneficiary's perspective, where the PRA's proposals are applied. MGS Guarantees And Private Sector Equivalent Schemes recognised, prudentially, on this basis by the beneficiary could therefore also be interpreted as not giving rise to "synthetic securitisation" or (as discussed above) "securitisation" provided that the protection provider is also either (like HMT) not prudentially regulated, or recognises a full (rather than tranched) exposure to the protected exposure.

We would welcome guidance supporting the interpretation articulated above.

If the PRA is open to this approach, the proposed terminology for the treatments (currently articulated as applying to "qualifying securitisations" could helpfully be amended to be more neutral in this respect e.g. they could be referred to as qualifying exposures benefitting from MGS Guarantees And Private Sector Equivalent Schemes, and the Securitisation (CRR) Part referred to as covering securitisation *and* qualifying exposures benefitting from MGS Guarantees And Private Sector Equivalent Schemes.

As indicated above, identification of MGS Guarantees And Private Sector Equivalent Schemes as constituting securitisations arguably prevents inclusion of the guaranteed assets in securitisations and hence their use to obtain funding or as collateral for liquidity purposes. We would welcome guidance that Securitisations of MGS and Equivalent Guaranteed Exposures should not be understood to constitute re-securitisations (or at least that they should not be understood to constitute re-securitisations where the benefit of the guarantee is not recognised prudentially, or (in line with the PRA's proposed prudential treatment) not recognised prudentially as creating securitisation positions, in the risk weighting of positions in the Securitisation of MGS and Equivalent Guaranteed Exposures (i.e. the guarantee is not treated as varying the capital requirements associated with the underlying assets through credit risk tranching) – see above), with sell-side parties being permitted to assume this provided that appropriate disclosures are made). Importantly, we request that the PRA does not use its powers of waiver to indicate that such deals are re-securitisations, but *permitted* re-securitisations.

As indicated above, identification of the guarantee provided in respect of retail residential mortgage loans under MGS Guarantees And Private Sector Equivalent Schemes as giving rise to a synthetic securitisation,

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[21] A "tranche" "means a contractually established segment of the credit risk associated with an exposure or a pool of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in another segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments".
[22] See paragraph 3.49 of CP 13/24 if there are more than two tranches in the Loan, the originator institution must hold "the entirety of all tranches in the Loan for which 5 * A + D, where A is the attachment point and D the detachment point of the tranche".

arguably prevents assets benefitting from MGS Guarantees And Private Sector Equivalent Schemes from being included in securitisations due to the potential for such securitisations to, in consequence, be classified, and prohibited, as re-securitisations[23]. As indicated above, on this basis, such schemes engage the adverse consequences of securitisation classification, while ruling out securitisation benefits in relation to the guaranteed assets: securitisation to obtain funding and/or liquidity and/or (in practice, due to the PRA's approach to commensurateness) prudential derecognition of the securitised assets and securitisation risk weighting.

We would welcome guidance to the effect that securitisations of assets benefitting from MGS Guarantees And Private Sector Equivalent Schemes (**Securitisations of MGS and Equivalent Guaranteed Exposures**) should not be understood to constitute re-securitisations (or at least that they should not be understood to constitute re-securitisations where the benefit of the guarantee is not recognised prudentially, or (in line with the PRA's proposed prudential treatment) not recognised as creating securitisation positions, in the risk weighting of positions in the Securitisation of MGS and Equivalent Guaranteed Exposures (i.e. not treated as varying the capital requirements associated with the underlying assets through credit risk tranching – see above (which the sell-side parties should be able to assume provided that appropriate disclosures are made)).

Importantly, we request that the PRA does not use its powers of waiver to indicate that such deals are re-securitisations, but *permitted* re-securitisations._The consequences of such an approach would include prudential treatment of affected deals as re-securitisations, which would be adverse[24], as well as failure to provide protection/comfort for non-UK parties (and indeed parties and deals not specifically covered by the waiver).

In the context of the requests for interpretative guidance above (and generally in relation to reforms implemented by the PRA), we note the desirability of achieving as much alignment and inter-operability as possible with other key jurisdictions, including the EU.

In the context of the requests for interpretative guidance above (and generally in relation to reforms implemented by the PRA, as noted in previous AFME consultation responses), we note the desirability of achieving as much alignment and inter-operability as possible with other key jurisdictions including the EU. Many UK securitisations (and most publicly-placed UK securitisations) will require access to EU investors, US investors or both, to say nothing of significant investors in other regions, including APAC. The result is that such securitisations, even where the sell-side entities are entirely based in the UK, will often need to consider and (to some degree) comply with the requirements of those other jurisdictions.

We welcome the progress made in facilitating recognition of MGS Guarantees And Private Sector Equivalent Schemes in the calculation of capital and Members anticipate applying and benefitting from the proposed mechanics, but recommend developing the proposed IRB approach to allow an LTV approach to be considered in LGD modelling.

The PRA proposes new prudential approaches to reflect the benefit of the guarantee in retail residential mortgage loans under MGS Guarantees And Private Sector Equivalent Schemes.

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[23] As defined in Article 2(4) of the Securitisation Regulation and Article 4(1)(63) CRR.

[24] For re-securitisations bank can *only* use modified version of the SEC-SA, with the p-factor set to 1.5, rather than 1 (i.e. a 150% rather than 100% uplift to underlying asset capital requirements), a risk weight floor of 100% (rather than 10% for STS or 15% for non STS), disapplication of the available caps (the maximum capital requirements cap and maximum risk weight cap for senior exposures) but with delinquencies (W) set to zero.

Specifically, the PRA proposes to require standardised banks to apply the loan splitting approach (under the CRR 3.1 general credit risk standardised approach) to the guaranteed loan, reflecting the guaranteed portion of the loan (which is zero risk weighted where provided by HMT) as effectively the *top slice* of LTV. For IRB banks (the IRB approach to credit risk does not include the loan splitting approach to residential mortgages), the PRA instructs banks to (in effect) treat the guarantee as a pro rata, rather than tranched first loss, credit protection, conditional on certain parameters relating to the tranche[25].

We welcome the progress made in facilitating recognition of MGS Guarantees And Private Sector Equivalent Schemes in the calculation of capital and Members anticipate applying and benefitting from the proposed mechanics.

However, in relation to the IRB approach, we recommend developing this approach (as contemplated by the PRA in CP13/24) to allow an LTV approach to be considered in LGD modelling in IRB, by stating that firms may include 'qualifying securitisation protection' within an IRB model to allow for an altered LTV where the protection is a government guarantee. Members' investigations indicate that this is a feasible change to the IRB model, specifically for a government guarantee, which is effectively 0% risk-weighted.

This approach would:

- capture the economic realities of the protection, which is explicitly designed to behave in the same way as a deposit, and hence impact LTV
- be consistent with the approach recommended for standardised assets; and
- adequately, and quantifiably, address the subordination of the MGS benefit.

The CRM rules provide protection on enforceability and legal clarity. LGD modelling would continue to be effective by recognising benefit to the extent of reducing the potential loss after the guarantee has been taken into account, and not be included in the consideration of the credit worthiness of the borrower.

We further request that the pro-rata approach currently outlined in CP13/24 in relation to the IRB approach be retained as a back stop, hence catering for the following situations:

- Where LGD modelling is not available to a firm, or is pending approval
- Where operational limitations prevent this adjustment from being implemented
- For non-government guarantors which will have a higher risk weight in their own right, but follow the same contractual pattern as the MGS.

We request that the PRA update its existing guidance in relation to MGS Guarantees And Private Sector Equivalent Schemes to reflect the new prudential approach and, if accepted, signpost circumstances in which MGS Guarantees And Private Sector Equivalent Schemes do not give rise to synthetic securitisations.

[25] See paragraph 3.49 of CP 13/24 if there are more than two tranches in the Loan, the originator institution must hold "the entirety of all tranches in the Loan for which 5 * A + D, where A is the attachment point and D the detachment point of the tranche".

We understand the proposal to be that the new prudential treatments (discussed above) apply as optional alternatives to demonstrating SRT and commensurateness and risk weighting in accordance with the existing securitisation framework (albeit that commensurateness is, in practice, hard to demonstrate in line with the PRA's current approach). We assume that the PRA's existing guidance in relation to MGS Guarantees And Private Sector Equivalent Schemes would remain valid in relation to prudential recognition under the existing securitisation framework, but would be grateful if it could be updated: (i) to signpost the existence of the new prudential treatment; (ii) to discuss the application of the helpful guidance it contains re transparency, SRT notification, transparency etc. to MGS Guarantees And Private Sector Equivalent Schemes benefitting from the new prudential treatment, where they give rise to synthetic securitisations; and (iii) if the PRA agrees with the analysis above re circumstances in which MGS Guarantees And Private Sector Equivalent Schemes do not give rise to synthetic securitisations, to signpost that analysis and the non-applicability in that case of other aspects of the guidance.

We would be grateful for confirmation, in relation to limb (c) of the proposed "qualifying securitisation" definition that this provision merely prohibits the recognition, in relation to a protected exposure, of multiple credit risk mitigation instruments with (as between themselves) different maturity dates, and is not a requirement for any or all of the credit protection to have the same maturity as the underlying exposure (a requirement that would not, for example, necessarily be satisfied in relation to the MGS with its 7 year maturity).

Proposal 3: *Supervisory expectations relating to the use of unfunded credit protection in synthetic significant risk transfer (SRT) securitisations*

We warmly welcome the PRA's proposal permit the use of unfunded credit mitigation (including credit insurance where it meets the requirements for guarantees) in synthetic securitisation. We believe that this development is likely to improve UK competitiveness, unlock significant additional deal-flow, and by facilitating the combination of funded and unfunded credit risk mitigation likely to diversify and hence improve due diligence and reduce systemic risk.

We would strongly support implementation of the proposal in advance of the 1 January 2026 implementation date for the changes in Chapter 3 (securitisation requirements) of the CP, as potentially envisaged by paragraph 3.175 of the CP (since it involves a change of approach/internal policy, only, rather than change to market facing written provisions).

We note that the PRA regards unfunded credit protection as a "complex feature" to be discussed by a firm with its supervisor at an early stage[26] and expects originators, as part of the monitoring and stress-testing of SRT transactions, to assess the risk of a downgrade of the protection provider and the implications for the effectiveness of the unfunded credit protection and the eligibility of the provider to continue to provide the unfunded credit protection, and to reflect this in their capital planning.

Other than these requirements, however, we understand that the PRA does not propose to impose super-equivalent requirements to the existing CRR requirements in relation to the use of unfunded credit risk mitigation in synthetic securitisations. We very much welcome this approach, which is aligned with international prudential standards and supports the competitiveness of UK banks, and members look forward to engaging with their supervisors on this basis in practice.

[26] 4A.2(ii) and 2.8 revised draft PRA SS 9/13.

We note that the credit risk mitigation framework (proposed to be implemented by the PRA in the PRA Rulebook with certain clarifications in relation to the application of the rules in a securitisation context) already provides mechanics requiring banks to account, prudentially, for the residual credit risk associated with unfunded credit protection providers, includes detailed requirements relating to protection eligibility, including credit rating requirements to write unfunded credit protection on securitisation positions.

The PRA should, in line with Basel and recent changes to the EU CRR, correct the drafting error which currently extends ratings requirements to e.g. central governments, central banks and MDBs.

In relation to the ratings requirements to write unfunded credit protection on securitisation positions, it should be clarified in the PRA's proposed implementation at Article 249(3) of Section 3 (Securitisation (CRR) Part) of the PRA Rulebook, that – in line with recent corrections to the EU CRR, and the scope of the equivalent rating requirement at Basel level[27] - the ratings requirement to write unfunded credit protection on securitisation positions applies only to providers within Article 201(1)(g), i.e. 'other corporate entities', including insurers[28], and not to all providers within 201(1)(a)-(h), such as, for example: central governments, central banks, MDBs, PSEs, institutions, and QCCPs.

Proposal 4: *Other changes to supervisory expectations relating to securitisations*

We agree that appropriately senior and qualified oversight of SRT transactions is of critical importance, but believe that the greater proposed prescription in relation to the identity of persons with oversight and approval for SRT securitisations will create bottlenecks.

The PRA proposes to require oversight and approval of SRT securitisations to be performed by the chief finance function (SMF 2) and any senior manager holding Prescribed Responsibility (PR) O[29], or AA[30] and CC[31], if a different person and to delete the existing wording permitting the level of senior management engagement to vary in line with the complexity of the transaction and the amount of reduction in RWA. While we agree that appropriately senior and qualified oversight of SRT transactions is of critical importance given the risk and capital management function of these transactions, the identification of specified SMF functions, this level of prescription is likely to lead to bottlenecks in large organisations, a level of proportionality to transaction significance in terms of RWA and complexity also seems pragmatic. We therefore suggest that, as a minimum in terms of flexibility, the relevant SMF be explicitly permitted to rely on demonstrable expert judgement in their chain of command following appropriate governance steps.

We would be grateful if the PRA could clarify that the new requirement for comparative information applies only to 'repeat' deals (if any).

The PRA proposes to require SRT notifications to include a "*comparison with relevant previous transactions, highlighting changes that may be relevant to the PRA's assessment and commenting on their rationale relevant previous transactions, highlighting changes that may be relevant to the PRA's assessment and commenting on their rationale*". We assume that such comparisons are only intended to be required to precedents for 'repeat'

[27] See Basel CRE 22.76(2)(b).

[28] "Other corporate entities, including parent undertakings, subsidiaries and affiliated corporate entities of the institution, where either of the following conditions is met: (i) those other corporate entities have a credit assessment by an ECAI; (ii) in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, those other corporate entities do not have a credit assessment by a recognised ECAI and are internally rated by the institution".

[29] On 'managing the allocation and maintenance of the firm's capital, funding and liquidity'.

[30] On 'implementing and managing the firm's risk management policies and procedures'.

[31] On 'managing the firm's financial resources'.

transactions (i.e. prior transaction(s) that are structurally very similar to the transaction for which approval is sought). It would be helpful if the PRA could clarify this, and add the words "if any" to the requirement and / or envisage the provision, in the alternative, of a statement by a firm to the effect that no such transactions have been identified.

The PRA's "feedback" in respect of SRT needs to be sufficiently certain to facilitate binary decision making by business, the previous reference to PRA "non-objection" was preferable.

We note that references in 3.9/3.10 of revised SS9/13 to the PRA providing a notice of "non-objection" or a "view" in relation to SRT have been replaced with references to the PRA providing "feedback". The decision whether or not to enter into a transaction structured for SRT compliance is a binary one, as is the decision as to whether to recognise capital relief in relation to such a transaction. It would clearly be unhelpful, in that context, for a bank's decision makers to receive feedback from the PRA that does not provide sufficient certainty, or is too nuanced. The previous reference to PRA "non-objection", in this context, was preferable.

Proposal 5: *Changes to the criteria for STS securitisations qualifying for differentiated capital treatment*

The risk weight limits to achieve STS prudential benefits should be reviewed, in detail, in light of the CRR 3.1 risk weighting changes. In particular: (i) the PRA's proposed Risk Sensitive Treatment for Unrated Corporate Exposures should permit a different election to be made by an institution for purpose of assigning risk weights to its securitisation positions backed by corporate exposures (on a consistent basis) irrespective of the election made for other purposes (to avoid the exclusion, in general, of unrated corporate exposures from STS securitisations), and (ii) a higher STS risk weight limit of 130% should be permitted for project finance in the pre-operational phase.

We note that the drafting in Article 243(1)(a) of the draft PRA securitisation rules has been updated to reflect the revised nomenclature associated with relevant asset classes post CRR 3.1. However, it is not clear to us whether the impact of the revisions to the substantive risk weights for these asset classes has been considered (at UK level, or indeed at Basel level, where the securitisation implications of the Basel 3.1 final reforms appear to have been little considered in general (see also the Output Floor Issue).

In relation to unrated (non-SME) corporate exposures, a bank must now, at institution level, elect whether to apply a flat 100% risk weight, or to apply a risk sensitive treatment under which exposures are assessed under a model to indicate whether the corporate is Investment Grade (resulting in a 65% risk weight) or Non-Investment Grade (resulting in a 135% risk weight) (the **Risk Sensitive Treatment for Unrated Corporate Exposures**). A securitisation may have tens of thousands of underlying assets which are not owned by the modelling institution, it is not possible to put each of these through an internal model (the institution may not have the data required to do this, and such an approach would be impractical for securitisations in the trading book), resulting, if the bank has elected, as an institution, to apply the Risk Sensitive Treatment for Unrated Corporate Exposures, in such exposures being assigned a 135% risk weight. This has the knock-on effect of disqualifying that corporate exposure securitisation from qualifying as an STS securitisation, given the applicable 100% risk weight limit.

To address this issue, the Risk Sensitive Treatment for Unrated Corporate Exposures (or the KSA and KA calculations themselves) should permit a different election to be made by an institution for purpose of assigning risk weights to its securitisation positions backed by corporate exposures (on a consistent basis), i.e. permitting a flat 100% risk weight for this purpose, irrespective of the election for other purposes.

The above issue in relation to the Risk Sensitive Treatment for Unrated Corporate Exposures is one example of a broader issue whereby the increase in risk sensitivity, in certain respects, of the standardised approach to credit risk under the PRA's CRR 3.1 proposals will require investors in third party (i.e. not own originated) securitisations to have access to data that is not currently available to them (see our response to DP 3/23 for further examples).

The new standardised approach specialised lending framework (which represents a sub-set of corporate exposures[32]) applies a risk weight of 130% to project finance exposures during the pre-operational phase[33], making such assets ineligible for STS, given the applicable 100% risk weight limit. Operational phase project finance assets will remain eligible for securitisation with prudential benefits within the STS framework, however a substantial part of a project finance book typically comprises pre-operational phase assets (and granularity is already a major issue) meaning that, from 2026, it will become very difficult for banks to issue STS project finance securitisations. The green and digital transitions that revival of the securitisation market could help to finance will require vast amounts of project finance lending by banks, including during the construction (pre-operational) phase. The risk weight limits to achieve the prudential benefits associated with STS status should be reviewed and a higher limit of 130% permitted for project finance in the pre-operational phase.

The risk weight limits to achieve STS prudential benefits appear to require revisiting, more broadly, in light of the Basel 3.1 changes. To provide some non-exclusive examples: Article 243(2)(b)(ii)(4) implies that an ADC exposure (a new sub-class of real estate) should be able to qualify, but requires a 50% risk weight on an individual exposure basis, whereas ADC exposures are proposed to be risk weighted at either 150% or 100%[34]. Similarly, Article 243(2)(b)(ii)(2) implies that a CRE exposure should be able to qualify, but requires a 50% risk weight on an individual exposure basis. Regulatory CRE exposures are currently risk weighted at (broadly) 50% risk weight up to 50% of market value/60% of the mortgage lending value (making this achievable), however, under the proposed new risk weights there are a large number of different risk weights, which relate to the counterparty together with different caps that apply[35]. For example, the minimum risk weight in relation to any part of a non-SME CRE exposure is 60%, while the cap for certain counterparties above an LTV of 80%, where repayment is materially dependent on cash flows from the property is 110%. Other risk weights can be cited that appear awkward in light of the reforms, for example the proposals imply that regulatory residential real estate where repayment is materially dependent on cashflows generated by the property would need to have an LTV < 70% in order to qualify for inclusion in an STS deal[36].

Proposal 6: *Change to the exposure value for certain undrawn portions of cash advance facilities*

No comments.

Proposal 7: *Changes and clarifications relating to the recognition of credit risk mitigation for securitisation positions*

Members welcome the additional clarity provided in the PRA's revisions to Article 249 and the related flowcharts in Appendix 1 to the PRA Rules for Securitisation.

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[32] See Article 122A(1) of the PRA Rulebook CRR Firms, Credit Risk: Standardised Approach (CRR).
[33] See proposed Article 122B of the PRA Rulebook CRR Firms, Credit Risk: Standardised Approach (CRR).
[34] See Article 124k CRR.
[35] See table 4 in the PRA's CP 9/24 https://www.bankofengland.co.uk/prudential-regulation/publication/2024/september/implementation-of-the-basel-3-1-standards-near-final-policy-statement-part-2.
[36] Article 124G(1) CRR.

Proposal 8: *Simplifications for Small Domestic Deposit Takers (SDDTs)*

We note that proposed treatment, as set out in Article 45A of the Own Funds (CRR) Part included in appendix 14 of CP 7/24[37], requires securitisation positions to be risk weighted at 1,250% where these positions, in aggregate with other items, represent less than 25% of CET1 and, thereafter, deducted from CET1. This treatment results in SDDTs being required to hold more capital than non-SDDTs for the same securitisation position, since non-SDDT banks are able to choose to deduct the securitisation position, in full, from CET1, effectively holding capital equal to the nominal value of the securitisation positions. The below example highlights this inequality, demonstrating significantly higher capital requirements for SDDTs particularly where the full securitisation position is subject to risk weighting.

	SDDT Bank A	SDDT Bank B	Non-SDDT Bank	
CET1 capital	500	1,000	1,000	
25% Threshold	125	250	N/a	
Securitisation position nominal	250	250	250	E
Subject to capital deduction	125	-	250	A
Subject to risk weight	125	250	N/A	
RWA @1250%	1,563	3,125	N/A	
RWA Capital Requirement 11.5%	180	359	N/a	B
Total capital requirement	**305**	**359**	**250**	**C=A+B**
Capital held in excess of securitisation position	**55**	**109**	**-**	**D=C-E**

Note: the assumed 11.5% capital requirement is equal to the minimum overall capital requirement for an SDDT bank being 8% Pillar 1 requirement + 3.5% Single Capital Buffer ("SCB"). This requirement could be higher where a P2A requirement or higher SCB is applied.

We would recommend that SDDTs be permitted, instead, to retain the choice to deduct or risk weight in line with non-SDDT banks, as per Article 245, noting that the proposed simplification provides no operational benefits, but rather adds greater complexity for SDDT banks relative to non-SDDT banks. If a single treatment is preferred in order to simplify the rules for SDDT banks, we would recommend that securitisation positions be required to be deducted in full from CET1.

Proposal 9: *Clarification of the circumstances for the application of the external ratings-based approach (SEC-ERBA) instead of the SEC-SA to all rated securitisation positions or positions in respect of which an inferred rating may be used*

No comments.

We understand that the nomination of ECAIs for securitisation risk weighting purposes, only, remains permitted and welcome this.

We note the amendments made by the PRA to paragraph (a) of Article 138 (which addresses ratings requirements in relation to risk weighting for non-securitisation positions) in its UK onshoring, whereby the

[37] https://www.bankofengland.co.uk/prudential-regulation/publication/2024/september/strong-and-simple-framework-the-simplified-capital-regime-for-sddts-cp

original flexibility to use ratings produced by an ECAI for a "*certain class of items*", only, is replaced with a requirement to use ratings produced by a nominated ECAI for "*for risk-weighting all types of exposures for which the nominated ECAI (or ECAIs) produce credit assessments*"[38]. We note further, however, that the use of ECAIs to rate securitisation positions is separately addressed at Article 270d within the Securitisation Part of the PRA Rulebook: CRR Firms. In this context, Article 270d provides, and continues in the draft PRA Rulebook: CRR Firms: CRR Instrument [2025] produced to accompany CP13/24 to provide, that "[*a*]*n institution may decide to nominate one or more ECAIs the credit assessments of which shall be used in the calculation of its risk-weighted exposure amounts under this Part [i.e. the Securitisation Part] (a 'nominated ECAI')*" (subject to the constraints identified in Article 270D(2)). We agree that ECAIs in this area tend to be specialist, and that their ratings may well not be appropriate to apply to a bank's other asset classes.

Proposal 10: *Statement of policy (SoP) in relation to permissions in the Securitisation (CRR) Part*

No comments.

Proposal 11: *SoP in relation to the use of powers referred to in the Securitisation (CRR) Part*

No comments.

We strongly believe (as accepted in the EBA SRT Report) that the assessment of quantitative risk transfer and commensurateness should be assessed upfront based on lifetime cashflow expectations and (generally) not brought down. CRR and Basel textual analysis indicates that this was the intention of rulemakers and it is purposively desirable to avoid instability and cliff effects in capital requirements as a transaction performs in the ordinary course (see Annex 1). Upfront assessment also appears appropriate for the 1.5 x K_{SA} protected tranche detachment point test for SA portfolios.

It would be helpful for the PRA to clarify in the SoP and elsewhere in the rules[39] that the assessment of quantitative risk transfer and commensurateness is assessed upfront based on expectations relating to cashflows and losses over the life of the transaction and not re-assessed other than in the event of restructuring of, or a transaction requiring implicit support notification with, the securitisation. This in line with the proposed position in the European Banking Authority (**EBA**)'s SRT Report (see Recommendation 14: When to run the SRT and CRT test[40]), which we support in this respect, while noting that the industry, the EBA in private, and an EC staff non-paper have all identified issues with the drafting of the proposed commensurateness tests, themselves, which, we suggest, should, therefore, not be adopted in the UK (at least without prior consultation and amendment). Textual analysis under the CRR and at Basel level can be advanced to support this position see Annex 1 (Purposive and Textual Reasons to Think That the SRT Tests and Commensurateness Tests Should Be Run At Inception Based on Expected Lifetime Performance and (Generally) Not Brought Down) as well as the purposive desirability of avoiding instability and cliff effects in capital requirements as the transaction performs in the ordinary course.

[38] See page 67 of the draft PRA RULEBOOK: CRR FIRMS: (CRR) INSTRUMENT [2024] accompanying accompany PS9/24: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf
[39] For example: paragraph 2.2 of SS 9/13 and Appendix 1 paragraph 3, of The PRA's Approach to the Exercise of Powers Referred to in Articles 233(3)(b), 245(3)(b), 245(4) and 258(2) of the Securitisation (CRR) Part of the PRA Rulebook.
[40] https://www.eba.europa.eu/sites/default/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20calls%20on%20the%20EU%20Commission%20to%20harmonise%20practices%20and%20processes%20for%20significant%20risk%20transfer%20assessments%20in%20securitisation/962027/EBA%20Report%20on%20SRT.pdf.

Upfront assessment also appears appropriate for the 1.5 x K_{SA} protected tranche detachment point test for SA portfolios[41]. Retained position risk-weights will reflect changes in potential tranche risk of loss (through realised losses driving attachment, and the reflection of defaulted exposures in KA) and (as in the case of the assessment of quantitative risk transfer and commensurateness) upfront testing will avoid cliff effects in transaction economics through sudden loss of SRT in adverse loss scenarios (which would be a concern if ongoing testing was a requirement). We would be grateful for clarification of this point by the PRA in the SS.

Proposal 12: *Minor modification and clarifications to the securitisation internal ratings-based approach (SEC-IRBA) and/or SEC-SA*

No comments.

Proposal 13: *Change to the SEC-SA in relation to exposures in default*

We support the modification of K_{SA} to exclude defaults captured by the W parameter and thus to avoid double counting.

Proposal 14: *Change to the calculation of maximum capital requirements for securitisation positions*

The proposed changes to Article 268 will typically not benefit originators in UK securitisations, as they are (we understand typically) required to sell the first loss tranche in order to achieve SRT. The equivalent reform envisaged in the EU[42] is likely to benefit originators in SRT securitisations as no equivalent sensitivity is understood to exist.

The proposed changes to Article 268 would be capable of benefitting the originator of an SRT securitisation in a transaction in which it retained the first loss tranche. However, as indicated in Annex 2 (Impact of Proposal 14: Change to the calculation of maximum capital requirements for securitisation positions), if U is set to the 5% risk retention percentage in a securitisation in which the originator satisfies the risk retention requirement via 5% holding through all issued securitisation positions, and in addition holds the entirety of the senior tranche, the changes proposed would effectively assign a 1,250% risk weight to every position retained in excess of the 5% risk retention. For such SRTs, setting U to 100% is therefore the only viable option (i.e. no change from the current position). This is an issue, because retaining a 5% holding through all issued securitisation positions in such a manner that it must be risk weighted through the securitisation hierarchy, without applying a pro rata ceiling to that retained portion, *independent of the existence of a further retained and tranched note*, can lead to a disproportionate capital requirement. The inadequacies of existing Article 268 have impeded banks' ability to develop structures in which retention is held in note form (as permitted by the risk retention rules), and hence created issues in bank's capital management.

[41]Included in section 8 of SS 9/13 – Securitisation: Significant Risk Transfer per the proposed amendments.
[42] See Recommendation 1 on page 40-41 of the JC of the ESAs' Advice on the Review of the Securitisation Prudential Framework (Banking) of 12 December 2022: https://www.eba.europa.eu/sites/default/files/document_library/Publications/Other%20publications/2022/Joint%20advice%20to%20the%20EU%20Commission%20on%20the%20review%20of%20the%20securitisation%20prudential%20framework/1045321/JC%202022%2066%20-%20JC%20Advice%20on%20the%20review%20of%20the%20securitisation%20prudential%20framework%20%20-%20Banking.pdf.

We would suggest that it would be more risk proportionate for the proposed calculation be amended to make Z(i) = "the *capital* on tranche i as it would be calculated under the securitisation hierarchy" (rather than its nominal value).

Separately, we interpret the reference in proposed Article 268 to U being set "by the institution for each securitisation" as meaning that 'U' is defined on a per transaction, rather than per institution basis and welcome this.

Proposal 15: *Notification of breaches of certain securitisation requirements*

Chapters 2 and 3 of the PRA Rules (Securitisation Part) include the PRA's very detailed rules relating to, not merely due diligence, but transparency, risk retention, credit granting and the ban on re-securitisation. While open dialogue between a bank and its supervisory contacts and full and frank disclosure of any breaches is essential, some form of materiality threshold *must* be required for notifications in order to avoid potentially significant time wasting for both banks and regulator. The notification obligation should, as a minimum, be qualified to require disclosure only "where an institution does not meet the requirements in 2.4 or in either Chapter 2 or Chapter 3 of the Securitisation Part*, in any material respect / respect of which the PRA would reasonably require notice,* by reason of the negligence or omission by the institution, the institution shall notify the PRA".

It is important in the context of the proposed reform that the PRA provide guidance/SoP to the effect (in line with current Article 14(2) CRR in relation to the additional risk weights envisaged in that Article and in current Article 270a CRR) that immaterial breaches of due diligence requirements by entities included in an institution's prudential consolidation, but established in third countries, are not anticipated to attract regulatory action/censure unless the breach is material in relation to the overall risk profile of the group. The current exemption/proportionality is widely relied upon in practice in the market.

Proposal 16: *Other minor changes*

We wonder if there is a reason why Article 47a(4) of the CRR (relating to circumstances in which exposures not subject to forbearance measure cease to be classified as non-performing) and Article 47a(5) of the CRR (indicating that classification of a non-performing exposure as non-current asset held for sale in accordance with the applicable accounting framework does not discontinue its classification as non-performing exposure) have not been replicated in Section 1.2 of Annex D (which generally replicates Article 47a.

Re the "securitisation position" definition in the Glossary, we would welcome confirmation, by the PRA, that it agrees with the distinction drawn, by the EBA in Q&A, between Retention Via Securitisation Positions and Retention Via Entitlement to Cash-flows (see below) and confirmation of the appropriate basis for risk weighting in relation to Retention Via Entitlement to Cash-flows.

In relation to the "securitisation position" definition in the Glossary section of the PRA Rulebook: CRR Firms: CRR Instrument [2025] published as part of CP13/24, we would welcome confirmation, by the PRA of its agreement with the distinction drawn in two responses to Q&A published by the EBA discussing the application of the "*securitisation position*" definition to methods for complying with the requirements of the EU Securitisation Regulation in respect of risk retention[43] and the EU Risk Retention Delegated Regulation,

[43] Under Article 6 EU Securitisation Regulation.

which are, by virtue of the cross-reference under Article 4(1)(62) EU CRR by reference to Article 2(19) of the EU Securitisation Regulation, relevant to the interpretation of that term in the EU CRR[44].

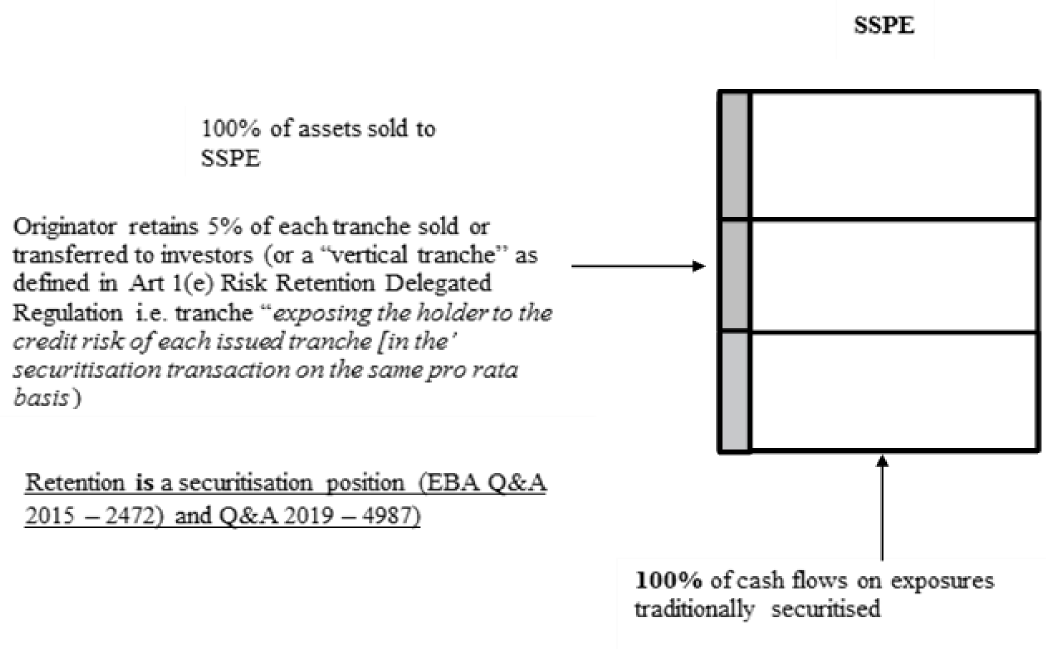
In relation to traditional securitisations, Q&A 2015_2472 and Q&A 2019-4987 essentially distinguish the following scenarios:

- a scenario in which 100% of the cash-flows on the exposures held by the SSPE are securitised, and retention takes the form of a 5% holding of each issued tranche of notes in the securitisation (or an instrument that is economically equivalent) (referred to as **Retention Via Securitisation Positions**) – in this case, the retention is characterised as a securitisation position; and

- a scenario in which only 95% of the cash-flows on the exposures held by the SSPE are securitised, and retention takes the form of an instrument (which may be a note) issued by the SSPE entitling the retainer to 5% of the cash-flows on the exposures held by the SSPE (referred to as **Retention Via Entitlement to Cash-flows**) – in this case, the retention is not characterised as a securitisation position.

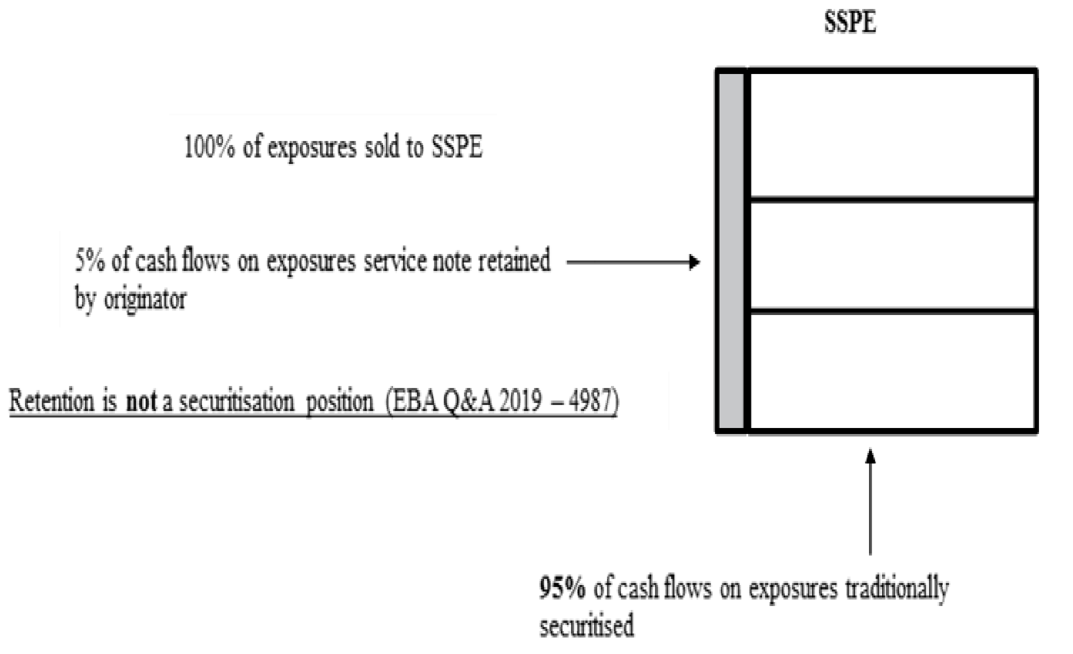
Retention Via Securitisation Positions and Retention Via Entitlement to Cash-flows are outlined in diagrammatic form below:

- **Retention Via Securitisation Positions:**



[44] In terms of the post-Brexit relevance of these Q&A (and in particular Q&A 2019-4987 which was published after exit day), the December 2020 'Bank of England and PRA Statement of Policy Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU' notes that, ESAs produce "*Q&As to facilitate common understanding of EU regulatory provisions*" and indicates that although these "*have no binding force*" the Bank of England and PRA "*[consider] that ESA Q&As may continue to be relevant, and that the Bank and PRA may have regard to these as appropriate*" (without distinguishing between Q&A published pre and post exit date).

- **Retention Via Entitlement to Cash-flows:**



Assuming that the PRA agrees with the distinction drawn, by the EBA, between Retention Via Securitisation Positions and Retention Via Entitlement to Cash-flows, the question arises as to the appropriate basis for risk weighting in relation to Retention Via Entitlement to Cash-flows (e.g. in line with the risk weight applicable to the underlying assets / as an exposure to an unrated corporate / securitisation risk weighting). We would be grateful for guidance from the PRA in this respect. Especially in relation to originators who have full knowledge of the underlying assets, and their RWAs, which will be superior to a blanket corporate assessment.

The concept of Retention via Cash flows could facilitate compliance with US Risk Retention Rules, which do not recognise retention in the form of a portion of each securitised asset[45], or of randomly selected assets[46], as permitted by the UK Risk Retention Requirements and EU Risk Retention Requirements (**Asset Based Risk Retention**), while maintaining the economics of Asset Based Risk Retention, and (consistent with maintaining the economics of Asset Based Risk Retention) a prudential analysis that avoids characterisation of the risk retention as a securitisation position (with the associated non-neutrality).

In the ordinary course of events, Retention Via Securitisation Positions is similar, in economic substance, to Retention Via Entitlement to Cash-flows. If an identical (e.g. 5%) percentage is held in all tranches, amounts lost on junior tranches will be re-couped on senior tranches and generate a return that is the same as an entitlement to 5% of the underlying asset cash-flows.

However, Retention Via Securitisation Positions will diverge in economic substance from Retention Via Entitlement to Cash-flows in the event of the retainer ceasing to hold an identical percentage of each issued tranche, for example, as a result of: (i) breach of the retention obligation; or (ii) settlement issues in circumstances where a retained securitisation position is used as collateral for secured funding purposes (as

[45] Article 5(1)(a) and Article 6 of each of the UK Risk Retention RTS and EU Risk Retention RTS.
[46] Article 6(3)(c) of each of the UK Securitisation Regulation and EU Securitisation Regulation.

is permitted under Article 12(2) of the Risk Retention Delegated Regulation and an identical provision in Chapter 4, Article 12(2) of the Securitisation part of the PRA Rulebook) (**Potential De-Coupling of Retained Securitisation Positions**). In this case, amounts lost on junior tranches will *not* necessarily be re-couped on senior tranches and generate a return that is the same as an entitlement to the same percentage of the underlying asset cash-flows[47].

Retention Via Securitisation Positions may also diverge, in economic substance, from Retention Via Entitlement to Cash-flows if the securitisation contains positions that affect the allocation of cash-flows but which are not generally considered as "*tranches sold or transferred to investors*" for purposes of the UK Risk Retention Requirements or EU Risk Retention Requirements (so that a retainer adopting Retention Via Securitisation Positions will not be exposed to a percentage share of these amounts).

[47] This risk is less pronounced where Retention Via Securitisation Positions if takes the form of a single instrument that is economically equivalent to holding an identical percentage of each issued tranche but potentially still present depending on the detailed documentation.

Chapter 6: Other CRR requirements

Proposal 2: *Restatement of certain capital requirements for credit risk*

1.1 Considerations on Article 119(5)

The PRA has proposed to update Article 119(5) to explicitly restrict the application of the provision to 'FCA investment firms'.[48] This reflects the existing supervisory guidance from the PRA and previously issued guidance from the FCA that no financial institutions under their respective supervision meets the criteria under the provision.[49] Our members have three main comments for the PRA on this proposal:

1. We welcome the PRA's position on investment firms and agree that FCA Investment Firms should maintain the 'institution' risk-weight treatment.[50] This reflects the robustness of the FCA's investment firm prudential regime (IFPR) and maintains the equality between domestic investment firms and equivalent third-country investment firms.[51]

2. However, we note that this does represent a permanent restriction of the applicability of this provision versus the original legal text in the CRR. Historically, this provision existed in the CRR (in the EU Official Journal) prior to the removal of 'investment firms' from the CRR definition of institutions and inclusion into the financial institution definition. Therefore, as trailed by in the consultation paper (paragraph 6.8), we would urge the PRA to consider extending the treatment to other prudentially regulated financial institutions within the UK.

3. Finally, we would like to highlight that the proposal would introduce an asymmetric treatment of exposures to domestic and third-country exchanges. As detailed under EBA Q&A 2013 677, a third-country exchange located in an equivalent jurisdiction should be treated as an institution for risk-weighting purposes under Article 107, and a domestic exchange can be treated as an institution under Article 119(5). The PRA's proposed change to Article 119(5) would prohibit the treatment of domestic exchanges as institutions. We would welcome PRA clarification on its intended approach for exchanges and to ensure equality between domestic and third-country entities.

1.2 General provisions

The introduction of IFRS 9 brought significant changes to how credit risk provisions are calculated, shifting from the incurred loss model to an expected credit loss (ECL) model. Under the new framework, banks are required to account for not only incurred losses but also expected future losses across different time horizons, specifically:

- **Stage 1:** 12-month ECL are recognised for assets that have not significantly deteriorated in credit quality since origination.

- **Stage 2 and Stage 3**: Lifetime ECLs are required for assets that show a significant increase in credit risk (stage 2) and for credit-impaired assets (Stage 3).

[48] As the only financial institutions subject to the requirements laid down under Part 9C.
[49] As stated by the PRA under SS 10/13 Chapter 2; and by the FCA under IFPRU 4.2.5 (not in force).
[50] As proposed under CP 13/24 Appendix 1 (page 121)
[51] Under UK CRR Article 107(3), third-country investment firms from equivalent judications shall be treated as institutions for risk-weighting purposes.

This is intended to provide a forward-looking view of potential losses and avoid losses being booked too late – reflecting the key criticism of the incurred loss model.

Notably, the IFRS9 standard allows for credit reserves **to be determined on a collective portfolio approach when appropriate, or on a borrower-specific basis**. This is broadly in line with the old incurred loss accounting model (IAS39), where losses could be assigned either individually or collectively. In both instances, collective portfolio losses tend to involve groups of financial assets with similar credit risk characteristics (e.g. retail).

Both the old and new standards do not therefore prescribe whether the assessment of significant increase in credit risk should be performed on an individual or collective basis. Banks may perform an assessment based on a mix of approaches.

Feed through to the prudential rules

Previously, when IAS39 standards were in place, the prudential rules broadly followed those in the accounting. The prudential rules contained two concepts: 1) specific provisions (for losses) and 2) collective provisions (called general provisions). The key thing determining whether a provision was general was whether the provision was "freely and fully available" to absorb losses. This is not possible where provisions are specific – once set against one firm this provision can only be reduced by considering the credit risk of that individual firm, it cannot be reduced in order to provision against another asset.

On this issue, the Basel Committee, in its original discussion paper on the regulatory treatment of accounting provisions[52] left the door open for jurisdictions to determine how provisions under IFRS 9 should be classified – whether they should be treated as general or specific provisions. BCBS has not arrived at a specific treatment: the standard simply references "alignment" with accounting standards.

The UK/EU approach

The UK inherited the EU approach on IFRS9 loss provisions, determined by an EBA Opinion in 2017. The EU decided to materially gold-plate the accounting approach, and decided that under IFRS9 the concept of general provisions was no longer appropriate. It was argued that this was because IFRS9 provisions are not 'freely and fully available' to meet losses because they are ascribed to specific exposures.

However, our view is that this isn't the case:

1. It is the EBA's approach which differs from the accounting approach. For financial reporting purposes only, there is a requirement to allocate or ascribe the ECL to individual assets. However, this is strictly a reporting requirement and is driven by statistical modelling and pro-rata allocation (e.g. size).

2. As noted, the availability of the collective provision under both accounting standards is similar i.e. to freely set aside provisions against a portfolio of assets.

This UK/EU approach has two notable negative impacts beyond misalignment with how loss provisioning works in practice:

[52] Basel Committee on Banking Supervision, Regulatory treatment of accounting provisions, Discussion document, October.

1. **Cost:** general provisions can be "added back" in regulatory capital (Tier 2).

2. **ECL procyclicality:** stage 1 and 2 provisions increase in a downturn as models incorporate higher probabilities of default. However, these provisions are often unwound as the economy recovers. This creates added cyclicality into banks' capital positions. This can be partially mitigated with general provisions: general provisions can be "added back" to tier 2 capital, as noted above. This serves to partially offset the loss provisioning, supporting the bank's capital position in times of stress.

We believe this is negative from both a financial stability, and a competitiveness/bank profitability perspective.

The UK/EU as an international outlier

Most jurisdictions (Hong Kong (HKMA)[53], Singapore (MAS), Canada (OSFI)[54] and the US[55] [56] go even further than simply aligning with the accounting standards, and declare that all stage 1 and stage 2 provisions are "general provisions" even if they are specific provisions under the accounting standard.

The HKMA's statement explains why: *"Given that the first two Stages (i.e. Stage 1 and Stage 2) of HKFRS 9 are concerned with exposures to assets that are not considered "credit-impaired", it appears not unreasonable for the impairment provisions pertaining to the exposures classified under these two Stages to be treated as GP, and for the impairment provisions pertaining to exposures classified under Stage 3 to be treated as SP, for capital adequacy purposes. The HKMA therefore proposes to adopt this approach as an interim measure pending the design and development of a longer-term solution by the BCBS"*.

Basel 3.1 impacts

The above shows how the UK/EU approach to collective portfolio provisions is out of step with how banks provision, and the impacts this has on UK banks. General provisions will also take on a heightened role under Basel 3.1 due to its interaction with the output floor. The output floor is inherently procyclical because internal model RWAs inflate quicker than standardised RWAs in a stress. As such, there is a risk that, in a stress, the output floor becomes more binding. This is a risk under an output floor with or without the PRA's ELs/ECLs adjustment.

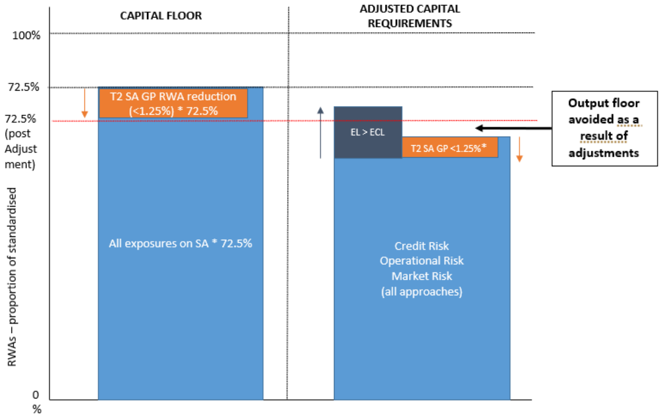
As noted earlier, general provisions reduce the cyclicality of provisioning by enabling some of the impact to be offset by tier 2 capital. Through the introduction of the PRA's ELs/ECLs adjustment, the PRA has introduced into rules the full formula which includes general provisions. This would, if general provisions were re-

[53] MABS(3) Completion Instructions – Annex II C [Completion Instructions (hkma.gov.hk)]
[54] OSFI 2.1..3.7: and IFRS 9 Guidelines
[55] Allowances for loan and lease losses (ALLL) means valuation allowances that have been established through a charge against earnings to cover estimated credit losses on loans, lease financing receivables or other extensions of credit as determined in accordance with GAAP. ALLL excludes "allocated transfer risk reserves." For purposes of this part, ALLL includes allowances that have been established through a charge against earnings to cover estimated credit losses associated with off-balance sheet credit exposures as determined in accordance with GAAP.
[56] ***Adjusted allowances for credit losses (AACL)*** means, with respect to a Board-regulated institution that has adopted CECL, valuation allowances that have been established through a charge against earnings or retained earnings for expected credit losses on financial assets measured at amortized cost and a lessor's net investment in leases that have been established to reduce the amortized cost basis of the assets to amounts expected to be collected as determined in accordance with GAAP. For purposes of this part, adjusted allowances for credit losses include allowances for expected credit losses on off-balance sheet credit exposures not accounted for as insurance as determined in accordance with GAAP. Adjusted allowances for credit losses exclude "allocated transfer risk reserves" and allowances created that reflect credit losses on purchased credit deteriorated assets and available-for-sale debt securities.

instated, provide an automatic counter to the procyclicality of the output floor: as stage 2 provisions increase, much of these would be general provisions and would be added back into tier 2, which would lower the SA approach RWAs used for the floor calculation:

The full Canadian model (aligned to the Basel consultation in 2015): BAU

1. Applies the concept of general provisions for SA by determining that all stage 1 and stage 2 ECL provisions are general provisions, included in Tier 2 capital (up to the cap of 1.25% RWAs)
2. Multiplying these capped general provisions by 1250%
3. Deducting these from the standardised RWAs (both in the capital floor and on the IRB side as appropriate where the bank has mixed IRB/SA exposures). Basel 1 floor calculation made similar adjustments, before it was demised (see appendix 4).
4. In this world, it is less likely that output floors will bite. It also ensures consistency in the way we compare SA against IRB approaches for floor calculations.



We would therefore recommend that the PRA realigns the prudential treatment of losses with the accounting standards which enables collective portfolio (or general provisioning, for prudential purposes) or specific provisioning where appropriate. This can be done via the PRA rulebook and the clarification via the existing RTS on the calculation of specific and general credit risk adjustments which were onshored as part of BREXIT and/or via a PRA statement which explicitly revokes existing EU guidance on this matter[57].

This would not create any additional financial stability risks, as evidenced by the adoption of this approach to general provisions in all other major financial jurisdictions apart from the EU. Arguably it will result in improvements from a financial stability perspective, as prudential losses will more accurately mirror the accounting approach.

1.3 Minority interest calculation

Under the PRA rules, the calculation of minority interest, (also known as non-controlling interest) in regulatory capital allows banks to include a portion of the capital held by minority shareholders in subsidiaries when calculating their consolidated capital. This inclusion is subject to strict conditions to ensure that minority interests are genuinely available to absorb losses at the group level.

The amount of minority interests that can be included is determined by assessing the surplus capital in the subsidiary over the lower of local or the contribution to the group regulatory minimum requirements. This is then allocated based on the minority shareholders' ownership percentage. Only the portion of this surplus capital attributable to minority interests that is available to cover losses at the parent level can be included in consolidated group's capital.

[57] EBA Opinion 2017: EBA publishes Opinion on transitional arrangements and credit risk adjustments due to the introduction of IFRS 9 | European Banking Authority

This “lower of” approach limits the PRA’s ability to take a risk informed-approach. Basel allows a limited recognition of minority interests in consolidated group own funds. The recognition is limited to the amount used to cover the subsidiary’s local minimum requirements and exclude the surplus capital of the subsidiary belonging to the third party. However, to ensure that the risk and capital allocated to the subsidiary do not exceed those determined at the consolidated level, a second safeguard was introduced, which limits the recognition to the requirements on consolidated level. Hence why the application of the ‘lower of’. The purpose of regulatory minority interest calculation is therefore to recognise at Group level only the amount of minority interests that would cover losses on consolidated level.

This objective will not always be best achieved by using the “lower of” the approaches. The PRA should allow flexibility in this regard, and this would ensure a more accurate determination of loss absorbing capital reflecting that:

- in a group structure, the minimum level of capital requirements applicable to the local entity may be considerably lower than those at group level, for example given additional Pillar 2 and capital buffers applicable at Group level.

- the group in this case holds significantly more capital, based on the contribution of the subsidiary to group requirements and this amount should be allowed to count as capital at group level where for example the subsidiary has surplus capital also when set against its contribution to Group requirements. This rationale would, in our mind, keep the calculation compliant with Basel as the amount recognised is effectively that which computes more accurately the risk and losses of the subsidiary at group level and the corresponding capital supplied.

Restrictions could be placed on when banks are able to deviate from the “lower of” approach, such as by ensuring that:

- there is sufficient loss absorbency of the additional amount (which is based on a regulatory requirement that applies to the subsidiary under Art. 84 (1)(a) point (ii) at consolidated level) is demonstrated by the institution (e.g. that the subsidiary continuously steers its own funds above the capital requirements that apply to it locally, and that the parent can ensure that the subsidiary meets its contribution to the consolidated capital requirements, Art. 84 (1) (a) point (ii) CRR) and

- given well capitalised subs minimise the likelihood of parent support protecting group CET1, a subsidiary which meets its stress testing requirements should be allowed to contribute higher amounts of capital given it provides further insulation from losses to other entities in the group.

The EU has already recognised this situation, and as part of CRR3[58] has provided for a waiver enabling banks to use the “higher” of local or group requirements where the regulator agrees this is a more accurate measure of loss absorbency. This in turn allows banks to lower the amount deducted from eligible minority interest and increased the amount part of consolidated group resources.

[58] Regulation 2024/1623 (“CRR3”) amendments to Art. 84 (1) Regulation - EU - 2024/1623 - EN - EUR-Lex (europa.eu): *“By way of derogation from point (a) of the first subparagraph, the competent authority may allow institutions to subtract either of the amounts referred to in point (i) or in point (ii), once the institution has demonstrated to the satisfaction of the competent authority that the additional amount of minority interest is available to absorb losses at consolidated level;”*

We propose that a similar approach is taken by the PRA to allow banks to include minority interests if the contribution of the subsidiary to group consolidated requirements is higher than local requirements recognising the additional capital at group level.

Additional clarification on the application of article 81(1)

In relation to the calculation of minority interests under Article 81(1), reference is made to 'CET1 items of a subsidiary'. It would be helpful if the PRA could provide clarity on whether the starting point of this calculation should be 'amounts before consolidation' so as to ensure consistency of application across banks. We note that the EBA[59] has previously provided guidance which may result in uncertainty. Specifically, certain entities in third countries may use local GAAP or local IFRS which may differ from Group IFRS so it is important to understand how the minority interests identified in the starting point of the MI should be identified as 'amounts before consolidation'. We welcome guidance from the PRA in this regard to ensure consistency in the calculation across the industry.

[59] 2021 5795 CET 1 Minority Interest Calculation and Forex conversion of non-EU subsidiary's financial statements | European Banking Authority (europa.eu)
2017 3111 Minority Interests | European Banking Authority (europa.eu)

Chapter 7: Mapping of external credit rating agency ratings to credit quality steps

The PRA has proposed changes to the rules and technical standard regarding the mapping of external ratings produced by credit rating agencies (CRAs) to credit quality steps (CQS). We would like to highlight to the PRA the following:

1. In Chapter 7 of the CP, the PRA have set out the updated rating scales, which map e.g. the Moody's global long-term rating scale to the relevant CQS. Behind this scale though, there are a variety of different credit ratings which are mapped to this scale. These are set out for example in Figure 2 of Appendix 1 of the EBA mapping report for Moody's referenced below[60]. It is unclear how firms should map credit ratings to the ratings scales in the first instance.

   We would like to seek further clarity on whether this is something the PRA plan to define on an ongoing basis as well or will this be up to firms to determine the appropriate mapping of credit ratings to ratings scales and the PRA will only map the later to CQS. For example, the 2021 S&P report referenced below[61] was adopted post Brexit and included new *credit rating* addition Financial Institution Resolution Counterparty Ratings and it is therefore unclear whether these may be used in the UK at present, although the expectation given the adoption of the relevant *credit rating scale* in the CP would indicate the intent is for them to be so – i.e. we would like clarity on whether if there are new credit ratings in the future firms may map these themselves to the relevant credit rating scales already mapped by the PRA in the CP and use accordingly or whether firms will need the PRA confirmation to map to the more granular named credit ratings issued by the agencies.

2. As part of the UK's implementation of the remaining Basel III Standards, the PRA's near-final Rules incorporate a restriction on the use of CRAs ratings for institutions where it incorporates an uplift for implicit government support (IGS). We recognise the prudential aim of creating a disconnect between the perceived credit quality of an institution and its central government. However, as we highlighted in conversations with the PRA in Q4 2024, the CRA market is not yet prepared to support the banking industry in complying with this new restriction and there are limited actions that firms can take to solve this market issue.

   Currently, there are no CRA ratings that have a compliant methodology with the new provision that is mapped to a CQS for capital purposes. As part of this consultation, we would be strongly supportive of the PRA including a mapping for the only new rating that is stated as compliant with the new provision - 'Fitch's XGS rating'. This would allow firms to systemically use this new rating across the institution exposure class, preventing a material re-allocation to the 'unrated institution' treatment. We would also urge the PRA (and FCA) to work closely with other CRAs to expediate the provision and mapping of compliant ratings.

   In addition, we would request that the PRA re-examines the impact of this new provision in light of the current readiness of the CRA market and consider introducing the transitional period provided by Basel (either five-years, or a delay until there is a robust offering of compliant ratings from CRAs). Aside from the availability of new compliant ratings, the process of evaluating whether an existing rating has an IGS uplift is operationality complex and costly, and in a large number of cases, not

[60] JC 2021 40 (Amended Draft Mapping Report - MOODYS).docx
[61] JC 2021 40 (Amended Draft Mapping Report – S&P).docx

possible. Therefore, without external change, firms are expected to only have one viable rating (Fitch's XGS rating) on 1 January 2026 and limited coverage in terms of the PRA's 'workaround'; resulting in a re-allocation of exposures from rated to unrated.

This is considered as an unintended consequence of this new provision, driven by the CRA market's readiness rather than the presence of the IGS (which the provision is aiming to address), and it expected to overestimate the risk once firms have access to compliant ratings.

3. Lastly, we note that as per Art. 111-122, 129 of the UK CRR, where a firm has nominated one or more rating agencies, it must use the credit assessments produced by the nominated rating agency for risk-weighting all types of exposures for which the nominated rating agency produces credit assessments. In other words, the same ratings agencies must be used across all exposure classes (as per Art.112 and 147 of the UK CRR). Historically, some of our members, have applied a different list of rating agencies to the securitisation vs other types of exposures. This is because securitisation exposures are niche, and the coverage of issuers may then be limited. Therefore, from an operational perspective, this will become a cumbersome process as firms will have to manually validate whether those credit rating agencies have produced ratings for all types of exposures. In the EU CRR, the text is unchanged and therefore allows to use rating agencies 'consistently for all exposures belonging to that class'. This issue was discussed recently at the PRA/AFME B3.1 meeting and the PRA advised to raise this point in the CP13/24 response. We would recommend to the PRA to retain the existing text in Article 138 paragraph (a) which states 'an institution which decides to use the credit assessments produced by an ECAI for a certain class of items shall use those credit assessments consistently for all exposures belonging to that class'.

Annex 1

Purposive and Textual Reasons to Think That the SRT Tests and Commensurateness Tests Should Be Run At Inception Based on Expected Lifetime Performance and (Generally) Not Brought Down

Although capital requirements for credit risk apply on an on-going basis, it seems unlikely that the switch from prudential recognition of assets to prudential recognition of securitisation positions, which is effected on achievement of SRT under the Basel and CRR securitisation frameworks, is intended to be reversed where risk transfer instruments absorb losses in accordance with their terms. Reversal of SRT in this way would lead to undesirable, sudden, volatility in capital requirements and is unlikely to have been the purposive intent of the legislators. We note that Articles 244(1)(a) and 245(1)(a) CRR (in this respect echoing Basel CRE 40.24) refer to the prudential switch from recognition of assets to securitisation positions as being effected where "*significant credit risk…**has been** transferred to third parties*", rather than where significant credit risk **is** transferred to third parties. We believe the better interpretation to be that the economic tests in Articles 244(2)/245(2) CRR (or 244(3)/245(3) CRR), which define significant credit risk for the purpose of Articles 244(1)(a) and 245(1)(a) CRR, are intended to be met at the inception of the transaction. Post closing amendment to the terms of the transaction to reduce the extent of economic risk transfer would fall foul of the ongoing prohibition on implicit support contained in Article 250 CRR, however, absorption of losses (which regulators are at liberty to, and indeed do, require be stress-tested upfront on a lifetime basis in assessing commensurateness) by risk transfer instruments in accordance with their terms should not threaten SRT. The documentary and structural requirements of Articles 244(4)/245(4) CRR (which are not qualified by the words "*has been*" in Articles 244(1)(a) and 245(1)(a) CRR) are required to be met on an on-going-basis.

We note that, under the CRR risk weighting mechanics for securitisation positions, the capital requirements for any retained securitisation positions held by the originator will adjust to reflect (amongst other things): (i) under the SEC-IRBA and SEC-SA, higher capital requirements on the underlying portfolio, with the entire capital requirement being 1,250% risk weighted/deducted, including (under the SEC-SA only) a deemed 50% capital charge for defaulted exposures; and (ii) under the SEC-ERBA, the worsening external credit ratings of securitisation positions.

If the economic tests in Articles 244(2)/245(2) CRR (or 244(3)/245(3) CRR) <u>are</u> applied post closing, a practice of systematically disregarding – for purposes of the tests - first loss tranches and mezzanine securitisation positions that are affected by principal shortfalls (in the sense that the holder will not, or is unlikely - depending on recoveries - to, receive payment) is at odds with the text of the CRR. A first loss position does not cease to be a "*contractually established segment of the credit risk associated with an exposure or a pool of exposures*" and hence a "*tranche*" (Article 2(6) of the Securitisation Regulation) and a "*first loss tranche*" (Article 2(18) of the Securitisation Regulation) merely because the holder will not, or is unlikely - depending on recoveries - to, receive payment*. Similarly, the point at which a mezzanine position that is affected by principal shortfalls ceases to be an "*asset or off balance sheet item*" and hence an "*exposure*" (Article 5(1) CRR) to a securitisation, a "*securitisation position*" (Article 2(19) of the Securitisation Regulation), and a "*mezzanine securitisation position*" for purposes of the tests, depends on the holder's accounting treatment and is, as such, variable, and not apparent to the originator. Such deal-specific and potentially differential analysis in relation to the point at which first loss tranches and mezzanine securitisation positions cease to be recognised for purposes of the tests cannot be intended, and supports an analysis of the credit structure based on the position at closing. Consistent with this, the "*underlying exposures*" and the credit risk associated with them (referred to in Articles 244(1)(a)/245(1)(a) CRR) would (by reference to the SEC-IRBA and SEC-SA calculation mechanics) include defaulted exposures, at least until the point of their accounting write off**.

* A first loss tranche embedded in a note, the principal amount of which is actually, permanently, written down to reflect losses might be said to cease to be a "*contractually established segment of the credit risk associated with an exposure or a pool of exposures*", but that would be an unusual structure (a retained first loss tranche in a synthetic transaction would typically not even be documented, while a reserve or a note would typically be unpaid due to subordination – i.e. its position in the waterfall - rather than written down), and the existence and timing of the write down would depend on the deal documentation.

** The exposure value of assets under the Standardised Approach is generally their accounting value after specific credit risk adjustments, additional value adjustments in accordance with Articles 34 and 110 and other own funds reductions related to the asset item[62]. However, Art 255(6) revised CRR (in line with the Basel equivalent provision[63]) indicates, that, for purposes of calculating K_{SA}, institutions must calculate the exposure value of the underlying exposures "*without netting any specific credit risk adjustments [or] additional value adjustments in accordance with Articles 34 and 110 and other own funds reductions*". The CRR definition of specific credit risk adjustments[64] does not explicitly exclude partial write-offs. However, an EBA Q&A Q exists[65] (albeit in the context of the IRB approach) which distinguishes write offs from impairments, and indicates that write offs: (i) are not included in the calculation of general and specific credit risk adjustments, but (ii) do reduce exposure value. Following this Q&A, although specific credit risk adjustments and additional value adjustments will not affect the underlying exposure balance, exposures will be removed from the underlying exposures for the purpose of the SEC-SA calculation to the extent written off (in part or whole) from an accounting perspective. Even if it is not correct to follow the Q&A and regard partial write offs as reducing the balance of the underlying exposures, given that an "*exposure*" for credit risk purposes is defined as an "*asset or off-balance sheet item*"[66], there will cease to be an exposure and hence underlying exposure at the point that no accounting asset remains (i.e. on a total write off). This interpretation appears consistent with the CRR position in relation to the SEC-IRBA where K_{IRB} is stated to include "*the amount of expected losses associated with all the underlying exposures of the securitisation including defaulted underlying exposures that are still part of the pool in accordance with Chapter 3*". Unlike the SA, the IRB approach (Chapter 3) does not[67] reduce exposure value to reflect credit risk adjustments[68] (instead, eligible provisions are compared to EL and the shortfall deducted from Tier 1 capital / the excess added to Tier 2 capital subject to specified limits). Following the EBA Q&A Q referred to above, however, a partial write off is not included in the calculation of general and specific credit risk adjustments and is interpreted as reducing the exposure value. As indicated above, a total write off will also mean that there is no longer an asset or off-balance sheet item, and so no exposure within the meaning of the Article 5 CRR definition, for the purposes of Chapter 3.

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[62] Art 111 CRR.

[63] "In cases where a bank has set aside a specific provision or has a non-refundable purchase price discount on an exposure in the pool, KSA must be calculated using the gross amount of the exposure without the specific provision and/or non-refundable purchase price discount." CRE 41.5 Basel securitisation framework.

[64] "credit risk adjustment" is defined in Art 4(1)(95 CRR to mean "the amount of specific and general loan loss provision for credit risks that has been recognised in the financial statements of the institution in accordance with the applicable accounting framework". A delegated regulation under Art 110(4) CRR specifies the calculation of specific and general credit risk adjustments: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014R0183-20220711. Under the delegated regulation, "all amounts by which an institution's Common Equity Tier 1 capital has been reduced in order to reflect losses exclusively related to credit risk according to the applicable accounting framework and recognised as such in the profit or loss account" need to be reflected either in general or specific credit risk (in accordance with the requirements of the delegated regulation) whether they result from "impairments, value adjustments or provisions for off-balance sheet items".

[65] See: https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2014_1064.

[66] Article 5 CRR.

[67] (other than in relation to equity exposures and other non-credit obligation assets).

[68] Although Basel also applies this treatment to partial write downs as well as provisions (See para 1.2 "Exposure at default in the linked Basel description of the current approach to accounting provisions on the IRB approach: https://www.bis.org/bcbs/publ/d385.pdf), a CRR Q&A question indicates that under the CRR partial write downs do reduce the exposure value rather than being compared to EL on the IRB approach (see: https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2014_1064).

Annex 2

Impact of Proposal 14: Change to the calculation of maximum capital requirements for securitisation positions

PORTFOLIO

Underlying Model	K-IRB
Notional	£700,000,000
Underlying RW%	50%
RWA	£350,000,000
RW% Floor	15%
RW% Cap	1250%
EEL	8%
VRR	5%
EL	5%

CP13/2024

3.157: The PRA's proposed rules to replace Article 268 of the CRR would modify the cap calculation so that a firm can exclude certain portions of tranches from it, if the firm then adds these portions onto the cap at their exposure value. **Currently, the cap is set at max(Vi)·K where Vi is the proportion of the i th tranche held by the firm and K is the capital requirement associated with the underlying exposures.** In the revised cap calculation, a firm could choose a percentage value, U, for each securitisation so that the cap is U·K plus, for every tranche where Vi is greater than U, an amount equal to (Vi−U) times the tranche exposure value. Firms would always be able to obtain the same outcome as in the current cap calculation, by setting U=max(Vi).

SCENARIO A

U	5%

Note	Tranche Size	Coupon	EAD (Z)	Underlying RWA	Underlying ECL	Capital requirement (Y)	Retained (Vi)	Sold	Total Max Capital	Total Implied RW%
A	70%	1.50%	490,000,000	245,000,000	24,500,000	269,500,000	100%	0%	478,975,000	1222%
B	20%	3.50%	140,000,000	70,000,000	7,000,000	77,000,000	5%	95%	3,850,000	34%
C	5%	5.00%	35,000,000	17,500,000	1,750,000	19,250,000	5%	95%	962,500	34%
D	5%	7.20%	35,000,000	17,500,000	1,750,000	19,250,000	5%	95%	962,500	34%
TOTAL			**700,000,000**	**350,000,000**	**35,000,000**	**385,000,000**			**484,750,000**	**866%**

SCENARIO B

U	100%

Note	Tranche Size	Coupon	EAD (Z)	Underlying RWA	Underlying ECL	Capital requirement (Y)	Retained (Vi)	Sold	Total Max Capital	Total Implied RW%
A	70%	1.50%	490,000,000	245,000,000	24,500,000	269,500,000	100%	0%	269,500,000	688%
B	20%	3.50%	140,000,000	70,000,000	7,000,000	77,000,000	5%	95%	77,000,000	688%
C	5%	5.00%	35,000,000	17,500,000	1,750,000	19,250,000	5%	95%	19,250,000	688%
D	5%	7.20%	35,000,000	17,500,000	1,750,000	19,250,000	5%	95%	19,250,000	688%
TOTAL			**700,000,000**	**350,000,000**	**35,000,000**	**385,000,000**			**385,000,000**	**688%**

Article 268 MAXIMUM CAPITAL REQUIREMENTS

1. An originator institution, a sponsor institution or other institution using the *SEC-IRBA* or an originator institution or sponsor institution using the *SEC-SA* or the *SEC-ERBA* may apply a maximum capital requirement for the securitisation position it holds equal to the capital requirement in paragraph 1A.

1A. The maximum capital requirement shall be calculated as follows:

$$\text{Max capital requirement} = U * Y + \sum_i \max(0, V_i - U) * Z_i$$

where:

U is a decimal point value between 0 and 1, set by the institution for each securitisation;

Y is equal to the credit risk capital requirements calculated in accordance with paragraphs 1B and 2;

Z_i is the nominal amount of the i^{th} tranche;

V_i is the proportion of interest that the institution holds in the i^{th} tranche, expressed as a percentage and calculated as the ratio of the nominal amount of the securitisation positions that the institution holds in a given tranche to the nominal amount of that tranche.

1B. The capital requirement Y in paragraph 1A is equal to the capital requirement that would be calculated under the Credit Risk: Standardised Approach (CRR) Part, Chapter 2 of Title II of Part Three of *CRR* or the Credit Risk: Internal Ratings Based Approach (CRR) Part in respect of the underlying exposures had they not been securitised. For the purposes of this Article, the *IRB Approach* capital requirement shall include the amount of the expected losses associated with those exposures calculated under the Credit Risk: Internal Ratings Based Approach (CRR) Part and that of unexpected losses.

2. In the case of *mixed pools*, the maximum capital requirement shall be determined by calculating the exposure-weighted average of the capital requirements of the *IRB Approach* and *Standardised Approach* portions of the underlying exposures in accordance with paragraph 1B.

3. [Note: Provision left blank]

4. When calculating the maximum capital requirement for a securitisation position in accordance with this Article, the entire amount of any gain on sale and credit-enhancing interest-only strips arising from the securitisation transaction shall be deducted from Common Equity Tier 1 items in accordance with Article 36(1)(k) of the Own Funds (CRR) Part.

[Note: This rule corresponds to Article 268 of the *CRR* as it applied immediately before its revocation]

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