Basel Committee on Banking Supervision Publishes Consultative Paper Regarding Revisions to the Securitization Framework

On December 18, 2012 the Basel Committee on Banking Supervision (the Committee) published a consultative document entitled "Revisions to the Securitisation Framework." The paper contains the Committee's proposed revisions to the securitization framework following its "fundamental review" of the existing framework. A copy of the consultative paper can be found here.

The consultative paper proposes several major changes to the existing standardized approach (SA) and internal ratings-based approach (IRB) securitization frameworks under Basel II as modified by Basel 2.5 and Basel III. The proposed framework in the consultative paper also differs in many significant respects from the risk-based capital rules for securitization exposures proposed by the US banking regulators in June of 2012.

The major changes proposed include the following:

1. A revised hierarchy for assigning risk weights to securitization exposures to be established between two alternatives.

2. Significant revisions to the Ratings-Based Approach (RBA) and Supervisory Formula Approach (SFA).

3. A Simplified Supervisory Formula Approach (SSFA).

4. Two versions of the concentration ratio approach introduced in the Basel 2.5 market risk guidelines.

5. The same 20% risk weight floor for the IRB as currently applies to securitization exposures under the SA.

The Committee is seeking comments on the proposal by March 15, 2013 and will conduct a quantitative impact study (QIS) of the proposal before proceeding further.

This Client Alert presents questions and answers about the (A) Background for the consultative paper, and the (B) Proposed New Hierarchies, (C) Proposed New and Modified Formulas, and (D) Other Specific Issues and Special Rules in the consultative paper. It concludes with a description of (E) Next Steps.

Background

Why does the Committee say it needs to revise the securitization framework?

The Committee concluded from its study of the financial crisis that both external ratings for, and bank assessments of, securitization exposures often did not accurately reflect their risks. As a practical matter, the Committee's proposal is to increase significantly the capital requirement for most (particularly senior) securitization exposures.

What does the Committee view as the main weaknesses of the existing securitization framework?

1. *Mechanistic reliance on external credit ratings*.

2. *Risk weights for highly-rated senior exposures that are too low*. According to the Committee, the models it used to calibrate the existing RBA (1) overestimated the diversification benefits of securitizations, (2) underestimated the significance of a securitization tranche's maturity, (3) failed to recognize the full significance of tranche thickness and of the interplay between tranche seniority and thickness, and (4) failed to capture the possibility of extremely large losses from unlikely events.

3. *Risk weights for low rated senior securitization exposures that are too high ("Cliff Effects")*. The Committee noted that downgrades of senior securitization exposures during the financial crisis led to dramatic ("cliff effect") increases in risk-based capital requirements that were not justified by the ultimate losses suffered by those downgraded exposures.

New Hierarchies

What are the two new proposed hierarchies?

The Committee proposes two possible hierarchies and asks for comments on the relative merits of Alternatives A and B.

Alternative A

<table>
<tr><td colspan="2" align="center">Modified Supervisory Formula Approach
↓</td></tr>
<tr><td colspan="2" align="center">(Jurisdiction's Choice)</td></tr>
<tr><td align="center">Revised Ratings Based Approach
(RRBA/IAA)</td><td align="center">Simplified SFA (SSFA)</td></tr>
<tr><td colspan="2" align="center">▼
Backstop Concentration Ratio Approach</td></tr>
<tr><td colspan="2" align="center">▼
1250% Risk Weight</td></tr>
</table>

A modified version of the SFA (MSFA) would be at the top of the Alternative A hierarchy. A bank would be required to use the MSFA for a securitization exposure if (1) use of the MSFA for that type of exposure had not been restricted by the supervisor for the relevant structure or transaction, (2) the bank was permitted to use the IRB for the underlying exposures, and (3) the bank had sufficient information to estimate the IRB capital requirement for *each* underlying exposure in the pool. If the first two requirements above were met, the bank would need to justify (for example due to lack of available data) why it did not use the MSFA for that exposure. Once a bank uses the MSFA for an exposure, it would be required to use it for the life of that exposure.

If a bank cannot use the MSFA for an exposure, the national regulator for that bank would establish whether the revised RBA (RRBA) or the Simplified Supervisory Formula Approach (SSFA), both described below, would apply.

Because SA banks are not permitted to use the IRB approach for underlying exposures, under Alternative A they would automatically use the RRBA or SSFA (depending on their home country's choice) as the primary procedure for computing risk weights.

In jurisdictions that adopt the RRBA, the Internal Assessment Approach (IAA) would be permitted to be used instead of the RRBA for support facilities to ABCP conduits, as is currently true under Basel II except for US banks that under GAAP consolidate ABCP conduits they sponsor.

If a bank could not apply any approach above, it would use the Backstop Concentration Ratio Approach (BCRA) described below.

If the bank could not compute the BCRA (unlikely), it would assign a 1250% risk weight to the exposure.

Alternative B

Senior high-quality tranches	**All other tranches**
RRBA/IAA or MSFA/SSFA ↓	K_{IRB}-based Concentration Ratio (CR_{KIRB}) ↓
Backstop Concentration Ratio Approach ↓	
1250% Risk Weight	

Under Alternative B, the hierarchies used are different depending on whether the exposure is a "senior high-quality securitization exposure." A "senior high-quality securitization exposure" is an exposure for which the bank can demonstrate that "the credit quality of the position is strong, with very low default risk, and is invulnerable to foreseeable events, implying that financial commitments would be met in a timely manner with a high degree of probability."

For a senior high-quality exposure, a bank could choose to apply the RRBA/IAA approach or the MFSA/SSFA approach. If the bank chose MFSA/SSFA, it could only apply the SSFA if the MFSA could not be used (because of unavailability of data, the bank's status as an SA bank, or otherwise). A bank would be required to apply the RRBA/IAA or MFSA/SSFA consistently over time based on internal policies not designed to minimize regulatory capital requirements. A bank would not be permitted to change its approach for an exposure without justification to its supervisor.

For exposures other than senior high-quality tranches, a bank would be required to use the K_{IRB} based concentration ratio described below.

For all exposures, if a bank could not apply any of the approaches described above (and no SA would be able to apply the CR_{KIRB} approach to an exposure) it would apply the BCRA. If the bank could not apply the BCRA (unlikely), it would assign a 1250% risk weight to the exposure.

How do Alternatives A and B compare to the existing Basel II hierarchies?

The existing Basel hierarchies for securitization exposures under the SA and IRB are as follows:

Existing Basel II Committee Capital Guidelines

STANDARDIZED APPROACH	IRB
RBA (with special rules for senior and ABCP conduit exposures) ↓	RBA ↓
1250% Risk Weight	IAA (for ABCP conduit exposures only) ↓
	SFA ↓
	1250% Risk Weight

Under Alternative A, the MSFA would replace the RBA at the top of the hierarchy for IRB banks. The RRBA/IAA would only be available in countries that adopted it over the SSFA and then only if the MSFA could not be computed. In countries that adopt the SSFA it would be the fallback if the MSFA could not be computed (and would be the first approach used by SA banks).

Under Alternative B, for senior high-quality securitization exposures the RBA would be replaced by either the RRBA/IAA or the MSFA/SSFA as the first approach. For non-senior high-quality securitization exposures, the CR_{KIRB} approach described below would replace the RBA and the SFA fallback, presumably leading to higher risk weights for those securitization exposures.

Under both Alternatives A and B, the new BCRA fallback would presumably result in lower risk weights than the 1250% risk weight that would apply under the existing Basel II guidelines were no other approach available, but would be the primary approach for SA banks calculating risk weights for securitization exposures other than “senior high-quality” securitization exposures.

Because both the MSFA and the CR_{KIRB} (as well as the IAA option under the RRBA) could only be applied by IRB banks, the de facto proposed hierarchies for SA banks would be:

De Facto SA Alternative A

(Jurisdiction’s Choice)	
Revised Ratings Based Approach(RRBA)	Simplified SFA (SSFA)
▼ Backstop Concentration Ratio Approach	
▼ 1250% Risk Weight	

De Facto SA Alternative B

Senior high-quality tranches	**All other tranches**
RRBA or SSFA ↓	↓
Backstop Concentration Ratio Approach ↓	
1250% Risk Weight	

How do Alternatives A and B compare to the hierarchies proposed by the US bank regulators?

The hierarchies proposed by the US regulators for SA and IRB banks are as follows:

Proposed US Capital Rules

<u>**STANDARDIZED APPROACH**</u>	<u>**IRB**</u>
SSFA or "gross up" similar to BCRA ↓	SFA ↓
1250% Risk Weight	SSFA ↓
	1250% Risk Weight

The proposed US hierarchies are similar to the Alternative A SSFA option. Under the US proposal, IRB banks would first apply the SFA. If a bank could not compute the SFA (for example because of a lack of required data), it would use the SSFA.

Under the US proposal, SA banks that are not "market risk banks" could choose to apply the SSFA or a simple "gross up" approach based on the risk weighting of the assets underlying the securitization exposure (which would produce results similar to the BCRA and, for senior exposures, the same result. Market risk banks must apply the SSFA.*

As required by Dodd-Frank, the proposed US rules do not contain an RBA (or RRBA)/IAA approach.

Dodd-Frank also means the risk-weighted assets computed under the proposed US SA would constitute the capital floor applicable to IRB banks under the Collins Amendment (Section 171 of Dodd-Frank).

*Market risk banks are SA banks with aggregate total trading assets and trading liabilities equal to 10% or more of quarter end total assets or $1 billion or more.

Proposed New or Modified Formulas

What are the proposed modifications to the RBA?

Two ratings always required

At least two eligible credit ratings would be required in order to apply the revised RBA (RRBA) to any exposure. The existing guidelines permit investing banks to use the RBA for an exposure with only one rating. As under the existing guidelines, the Committee proposes that the second highest available credit rating would be used.

Revised RBA parameters yield higher risk weights, especially for investment grade exposures

Separate revised RBA parameters would apply to senior and non-senior tranches. Both would be adjusted by tranche maturity. Non-senior tranches would also be adjusted based on their thickness. No tranche would receive any credit for granularity. The Committee concluded that the granularity of the underlying assets for a securitization exposure did not reduce the risk of the exposure.

Page 16 of the Committee's proposal provides illustrative risk weights for securitization exposures under the RRBA. Page 17 provides existing RBA risk weights for the same exposures. These tables show that the RRBA would dramatically increase risk weights for investment grade rated exposures through BBB (but especially through A-).

Alternative A's RRBA penalizes thin subordinate tranches

Alternative B only authorizes the RRBA for senior exposures (thereby imposing the K_{IRB} based Concentration Ratio on subordinate exposures). While Alternative A would permit banks to use the RRBA for non-senior exposures, it applies a special formula to subordinate exposures that increases risk weighting based on the subordination level and thickness of the tranche.

National regulators would have discretion to increase risk weights for "high-risk" asset pools

The Committee is also proposing that national regulators be given discretion to increase capital requirements from RRBA amounts for securitization exposures backed by high-risk pools of assets.

SA banks permitted to use inferred ratings

Currently, only IRB banks can use inferred ratings. The Committee proposes to expand the SA to permit SA banks to use inferred ratings on the same basis as IRB banks. The Committee states it intends to lessen differences between the SA and IRB approaches

How would the SFA be modified?

The proposed modified SFA (MSFA) would incorporate a maturity adjustment at the tranche level. The current SFA only looks at defaults over a one year time horizon, which the Committee now views as resulting in understated capital requirements for securitization exposures with longer maturities.

The MSFA would only be available for an exposure if the bank could develop IRB parameter estimates for each individual pool asset. The existing SFA permits a bank to use IRB parameter estimates for pool segments for retail exposures and for wholesale exposures with maturities of less than one year.

Banks investing in securitization exposures have already expressed significant concerns about the availability of the information needed to calculate risk weights using the *existing* SFA. The proposed revisions would presumably make it much less likely that investing banks could use the SFA. Under the Committee's Alternative A proposal they would default to the SSFA or RRBA/IAA approach depending on their home country's choice. Under Alternative B they would default to the SSFA if they chose to apply MSFA/SSFA instead of RRBA/IAA.

The supervisory adjustment factors “tau” and “omega” would be adjusted downward from the existing SFA. These adjustments are designed to reduce cliff effects for junior exposures and to “introduce more conservatism” for senior exposures, which the Committee believes incur insufficient capital requirements under the existing SFA.

What is the Simplified Supervisory Formula Approach (SSFA)?

The SSFA is, as it sounds, a simplified version of the SFA that follows closely the SSFA adopted in the US market risk rules and proposed for the banking book in the June 2012 US proposal. As in the US, the Committee’s proposed SSFA requires the use of five parameters:

1. K_{SA}- the weighted average capital requirement of the underlying assets under the standardized approach,

2. *A*- the attachment point of the securitization exposure (the percentage threshold at which asset losses would first be allocated to the exposure),

3. *D*- the detachment point of the securitization exposure (the percentage threshold at which losses would no longer be allocated to the exposure),

4. *p*- the supervisory adjustment factor, which equals 1.5 under the proposal, and

5. *W*- delinquencies of the underlying assets.

If the detachment point (D) of the exposure is less than the K_{SA} of the underlying assets adjusted over time based on portfolio delinquencies (K_A), the risk weight of the exposure is 1250%.

If the attachment point of the exposure (A) is greater than or equal to the adjusted capital requirement of the underlying pool (K_A) the capital requirement of the exposure is determined using the SSFA formula.

If the attachment point (A) is less than the adjusted capital requirement of the underlying pool (K_A) but the detachment point (D) is greater than K_A, the risk weight is a weighted average of (i) 1250% for the portion of the exposure up to and including K_A and (ii) the risk weight computed using *the SSFA formula for the remainder of the exposure.*

How does the proposed SSFA differ from the US version?

The SSFA as proposed by the Committee is essentially the same as the SSFA adopted in the US for the market risk rules and proposed for the risk-based capital rules, *except* the Committee’s proposed supervisory adjustment factor “p” for securitization exposures would be 1.5 instead of the 0.5 adopted for market risk and proposed for risk-based capital in the US. Also, the Committee proposes that *resecuritization* exposures not be subject to the SSFA (only the BCRA described below). In the US proposal (and in the adopted market risk rules in the US) only *resecuritization* exposures would be adjusted by a 1.5 p factor.

The Committee specifically states it proposes calibrating the SSFA “more conservatively” than the US regulators. It also states that its proposed calibration is intended to produce capital requirements that are “roughly comparable and slightly higher than those generated by the MSFA.”

What are the “Concentration Ratio Based Approaches?”

The Committee proposed two “concentration ratio based” formulas that operate much like the “gross-up” approach proposed in the US. Each formula results in a capital requirement based on the capital requirement for the assets underlying the exposure and the “detachment point” (D) for that exposure.

What is the Concentration Ratio based on K_{IRB} (CR_{KIRB})?

The CR_{KIRB} is written as:

Min (1250%; 12.5 x (K_{IRB}/D))

This proposed ratio would only apply if Alternative B is adopted and then would only apply to securitization exposures that are not "senior high-quality exposures." Because the formula requires a bank to compute K_{IRB} for each asset underlying a securitization exposure, no SA bank would be able to use this approach and IRB banks would not be able to apply it to purchased securitization exposures for which they could not obtain the required data (such as many purchased exposures).

Because the detachment point (D) of the exposure is the only variable input other than K_{IRB}, the CR_{KIRB} does not take into account the benefit of any credit enhancement available to the exposure.

What is the Backstop Concentration Ratio Approach (BCRA)?

Under both Alternatives A and B, this simplified concentration ratio (based on standardized rather than IRB risk weights for the assets underlying a securitization exposure) is the final "fallback" for computing the capital requirement for a securitization exposure before applying a 1,250% risk weight to the exposure.

The BCRA formula is

Min (1250%; F x 12.5 x (K_{SA}/D))

where F = 1 for senior securitization exposures; and F = 2 for non-senior securitization exposures.

Because K_{SA} is the weighted average SA risk weight for the assets underlying the securitization exposures, banks should be able to apply the BCRA to many more securitization exposures than the CR_{KIRB}. Because the BCRA formula applies an F of 2 for non-senior securitization exposures, the risk weight for those exposures will be twice what would be implied by the detachment point D for the exposure. Even though the detachment point D already "grosses up" the capital requirement (K_{SA}) for the underlying exposures supporting a subordinated tranche, the Committee states that the F of 2 adds "more conservatism" to the capital requirement for non-senior tranches to recognize "their increased risk relative to senior tranches" and to "protect against arbitrage opportunities."

As with all securitization exposures, the risk weights computed using the BCRA would be subject to the overall "cap" that the risk-weighted assets (RWA) produced by all exposures held by a bank in a single securitization could not exceed the RWA that would be produced by holding all the underlying exposures of that securitization on the bank's balance sheet.

Is the BCRA the same as the gross-up approach proposed in the US?

No. Although the risk weights computed for senior securitization exposures under the BCRA would be the same as those computed using the US "gross-up" approach, the US only permits SA banks to use the gross-up approach. Also, the US gross-up formula has no factor equivalent to the F of 2 for subordinate exposures that doubles the risk weight for such an exposure under the BCRA.

Other Specific Issues and Special Rules

How is the concept of maturity (M) used?

Tranche maturity (M) would be used for the first time as a direct input in both the revised RBA (RRBA) and the MSFA. Similar to the definition currently used in the wholesale IRB framework, M would be based on the weighted-average maturity of the contractual cash flows of the tranche. Alternatively, a bank could simply use the final legal maturity of the tranche. As under the wholesale IRB framework, tranche maturity would have a 5- year cap and a 1-year floor.

Contractual payments that are the basis for tranche maturity must be unconditional and not dependent on the actual performance of the underlying assets. If such unconditional contractual payment dates do not exist, a bank must use the final legal maturity of the tranche.

In cases where a bank provides a commitment that could expose the bank to risk for a longer period than the contractual maturity of the commitment (for example until the maturity of the underlying assets), this longer period would be used as M. If the asset pool revolves, the latest possible maturity of an asset that might be added during the revolving period would be used to calculate M.

For credit protection instruments such as credit default swaps that are only exposed to losses that occur by the maturity date of the instrument, a bank would use that contractual maturity of the instrument as M, not the latest maturity date of the underlying protected asset or position.

Does the US proposal also use maturity (M) this way?

No. The proposed US version of the SFA does not include the concept of tranche maturity and continues to use the one-year default horizon that is criticized by the Committee. Because the US proposal (as required by Section 939A of Dodd-Frank) does not include a ratings based approach, the Committee's proposed use of M in the RRBA is not relevant to the US proposal.

How are resecuritizations treated?

The Committee proposes that the risk weights for all resecuritization exposures be computed using only the Backstop Concentration Ratio Approach (BCRA). This rule would apply to both SA and IRB banks and under both the Alternative A and B hierarchies. IRB banks would not be permitted to apply the CR_{KIRB} to resecuritization exposures.

The F factor of 2 for subordinate securitization exposures, however, *would not* apply to subordinate resecuritization exposures under the BCRA. The Committee explains that the "conservative" risk weights assigned to securitization exposures should be sufficient and not require a 2x gross up for subordinate resecuritization exposures under the BCRA.

What about mixed pools of securitization and non-securitization exposures?

Unlike with mixed pools of SA and IRB assets (for which the SA capital requirement would apply to all assets) the Committee proposes to treat a tranche representing a claim on a mixed pool of securitization and non-securitization exposures as two separate pools. This means non-senior tranches of such "mixed pools" would not incur the doubling of risk weights generally applied to non-senior tranches *to the extent the tranche contained securitization exposures.* The percentage of the non-senior tranche supported by non-securitization exposures (i.e., the percentage of underlying assets that were not securitization exposures) would be subject to the F factor of 2 (i.e., a doubling of the risk weight otherwise computed under the BCRA).

The Committee specifically asks for comments on whether its treatment of mixed pools (both in requiring banks to consistently use the SA for all assets in a mixed pool of SA and IRB assets and in permitting banks to use a weighted average of securitization and non-securitization underlying exposures in applying the BCRA to subordinate tranches) is appropriate.

Is the proposed US treatment of resecuritizations the same as the Committee's proposal?

No. The US proposal did not contain a BCRA or similar treatment for resecuritization exposures. Resecuritization exposures would be subject to the SFA or SSFA like any other securitization exposure. As described above, the proposed US SSFA would apply a 1.5 parameter "p" to resecuritization exposures. The Committee proposes a p of 1.5 for *all* securitization exposures using the SSFA but would require banks to apply the BCRA to all resecuritization exposures

Would non-investment grade exposures of originators still be deducted from capital under the SA?

No. The Committee proposes eliminating this requirement in the revised framework in order to better align the SA and IRB approaches and to reduce cliff effects. Non-investment grade securitization exposures retained by originators would be risk-weighted under the SA the same as all other non-investment grade exposures.

How are securitization exposures to asset-backed commercial paper conduits treated?

The Committee proposes to retain the IAA for IRB banks as an alternative for unrated positions under the RRBA.

The Committee proposes to *eliminate* the following special treatments of securitization exposures to ABCP conduits under the SA:

1. *Second loss positions to ABCP conduits (typically program-wide credit facilities).* As a fallback to avoid deducting such an exposure from capital when other methods can not be applied to the exposure, the existing securitization framework permits banks to use a risk weight of 100% or, if higher, the highest risk weight of any asset in the underlying pool, *if* the exposure has an investment grade equivalent credit risk and is supported by significant first loss protection. The Committee views this special treatment as unnecessary given the introduction of the BCRA as the new final fallback before applying a 1250% risk weight. As subordinate exposures, such second loss positions would have their risk weights doubled through the F factor of 2 in the BCRA formula.

2. *Ability of IRB banks to use SA risk weights for liquidity facilities.* For the same reason, the Committee views this fallback as unnecessary in light of the BCRA (which would *not* have their risk weights doubled through the F of 2 in the BCRA formula, since such facilities are senior exposures).

3. *50% credit conversion factor for eligible liquidity facilities provided by SA banks.* The Committee proposes to eliminate this treatment but does not provide a specific substantive rationale for doing so. Instead it proposes to do so to "further simplify the framework." Eligible liquidity facilities provided by SA banks, therefore, would be treated the same as on-balance sheet exposures and *not the same* as other loan or purchase commitments provided by such banks.

Do the US regulators propose these same changes for exposures to ABCP conduits?

No. In the US proposal SA banks could continue to determine the risk weight of an investment grade equivalent second loss position in ABCP conduit programs using the highest risk weight of any underlying asset (subject to a 100% floor). Similarly, an SA bank would apply a 50% CCF to an eligible liquidity facility if it computed the facility's risk weight using any method other than the SSFA.

The one consistency between the US proposal and these Committee proposals is that advanced approaches banks in the US also would not be permitted to use SA risk weights for eligible liquidity facilities. They, however, would not apply a BCRA type approach to those facilities. The US "gross-up" approach for securitization exposures, which reaches results similar to the BCRA, is only available to SA banks.

Does the Committee propose that all securitization exposures have a minimum risk weight of 20% regardless of how well protected they are?

Yes. The 20% floor already applies to SA banks. The Committee proposes increasing the floor for IRB banks to 20% from 7% for all securitization exposures. US regulators proposed the same 20% floor in June 2012 for advanced approaches and SA banks.

Does the Committee propose an overall cap on the capital charge for securitization exposures held by a bank?

Yes. The Committee proposes to retain the existing IRB framework provision that limits a bank's capital charge for exposures held under a single securitization to the IRB capital requirement that would have been assessed against the underlying exposures if held directly by the bank. The Committee's proposal would extend the benefit of this cap to SA banks that are originators and sponsors of securitizations based on the SA capital charge for the underlying assets.

The Committee views securitization as a form credit risk mitigation that should reduce (*and never increase*) risk by transferring some of the risk of the securitized assets to one or more third parties. Under this view, the Committee believes a bank should never be required to hold more capital to support securitization exposures than it would be required to hold if the assets were not securitized but held on the bank's balance sheet.

Is this also true under the US proposal?

Not for SA banks. The proposed US advanced approaches rules would retain a similar existing provision that limits a bank's capital charges for a single securitization to the sum of the bank's capital charges for the underlying assets if held on balance sheet and not securitized plus the total expected credit losses on those underlying assets. The proposed US version of the SA, however, does not contain such a limiting provision. US regulators have specifically rejected the Committee's view and acknowledged that a bank might be required to hold more capital for multiple tranches of a single securitization than it would if it held all the underlying exposures for that securitization on its balance sheet.

Does the Committee propose to cap the risk weight of the most senior securitization exposures?

Yes. The existing SA (by a "look through") effectively caps the risk weight of the most senior exposure in an unrated securitization at the weighted average SA risk weight of the pool of underlying assets. The Committee proposes to expand this cap to cover rated transactions.

The Committee also proposes to add an equivalent cap to the IRB. This would cap a senior tranche's risk weight at the weighted average IRB risk weight for the underlying assets. IRB banks, however, would need to be able to compute K_{IRB} for all underlying exposures to take advantage of this cap.

The Committee also considered whether the CR_{KIRB} could be applied to all exposures for which a bank could calculate K_{IRB}, thereby acting as a de facto additional cap. Based on QIS results, the Committee will decide whether to add a CR_{KIRB} cap.

Does the US proposal include such a cap?

No. The US proposal does not provide any risk weight cap other than the existing cap on total capital requirements for any securitization transaction for advanced approaches banks described above.

How are securitizations with early amortization provisions treated?

Any securitization of revolving assets with an early amortization provision would be treated as not being a securitization. Instead, the bank securitizing the revolving assets would be treated as retaining the assets on its balance sheet (unless the early amortization provision could somehow be shown to not "in any way increase the bank's exposure to losses" on the underlying assets). The Committee stated that securitizations with controlled and non-controlled early amortization provisions "typically result in very limited, if any, transfer of risk to investors."

Is this the same in the US proposal?

Yes. The US proposal provides that early amortization provisions violate the operational requirements for a securitization.

How are write-downs and purchase discounts treated under the proposal?

The Committee proposes that the carrying value of a securitization exposure be used as the exposure amount for purposes of calculating capital requirements. This is consistent with the proposed US rules and the current US version of the Basel II IRB framework.

The Committee indicated that it does not support allowing purchase discounts and write-downs to directly offset capital requirements as is currently the case in some jurisdictions. The Committee is concerned that doing so would give an excessive capital benefit to write-downs and discounts. US regulators have also rejected requests that the amount of purchase discounts or write downs be treated as credit enhancement under the SFA and SSFA.

Next Steps

The Committee is seeking comments on the proposal by March 15, 2013. The Committee will also conduct a quantitative impact study (QIS) on the proposal. The Committee indicated it would consider the comments it receives and the QIS before proceeding further.

It is unclear whether the US will modify its capital proposals based on these proposals or any final revisions to the securitization framework issued by the Committee. Since the Committee proposes allowing national regulators to adopt alternatives to the RRBA under both Alternatives A and B, the proposed new securitization framework would not be inconsistent with Dodd-Frank in the same way as the existing Basel framework that requires the use of ratings.

To discuss any of the topics discussed in this Client Alert, contact Tim Mohan at mohan@chapman.com (312.845.2966) or any other member of the Asset Securitization Group.