



Securitization Perspectives on Risk-Based Capital Requirements

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Introduction to Risk-Based Capital Rules

In July 2013, the Federal Reserve Board, the FDIC and the OCC (the **Agencies**) adopted the Final U.S. Basel III Rule, which incorporates changes made by the Basel Committee on Banking Supervision (**BCBS**) to the risk-based capital rules in the Basel III capital framework (**the BCBS Guidelines**).

Dodd-Frank Drives Key Differences in U.S. Rules

- **Section 939A:** While external credit ratings are an important component of assigning risk weights under the BCBS, Section 939A of Dodd-Frank requires that references to ratings be removed from federal regulations and that alternative creditworthiness standards be substituted in their place.
- **Collins Amendment:** The Collins Amendment to Dodd-Frank (Section 171) imposes a permanent capital floor on U.S. banks based on capital requirements in effect on July 21, 2010. This capital floor will be based upon the standardized approach risk-based capital rules (the **Standardized Approach**) adopted in July 2013.

Relevant Methods of Calculating Risk Weights for Securitization Exposures – U.S. Rules and BCBS Guidelines

Ratings-Based Approach (RBA) <i>(not available in U.S.)</i>	Risk weight is assigned based upon the publicly available ratings of the exposure.
Supervisory Formula Approach (SFA)	Risk parameters (<i>e.g.</i> , probability of default, loss given default, exposure at default) are assigned to the underlying securitized assets using approved internal methodologies and the capital of the related securitization exposure is determined using a formula that takes into account these risk parameters, the seniority and thickness of the exposure and available credit enhancement.
Simplified Supervisory Formula Approach (SSFA)	A simplified version of the SFA under which risk weights are assigned to the securitized exposures using the Standardized Approach, which is not risk-sensitive to the specific credit quality of these exposures. (For example, all equipment loans would be assigned a 100% risk weight regardless of their relative credit quality). The risk weight of the related securitization exposure is largely a function of these underlying asset risk weights, the seniority of the exposure and available credit enhancement.
Internal Assessment Approach (IAA) <i>(not available in the U.S.)</i>	Allows assignment of risk weights to credit and liquidity facilities to asset-backed commercial paper conduits using internal ratings that are calibrated to external ratings and the RBA using rating agency methodology for the relevant asset class.

Assigning Risk Weights to Securitization Exposures – Standardized Approach Banks

Final U.S. Basel III Rule – Standardized Approach Banks	
Hierarchy	(1) SSFA (2) 1250%
Risk Weight Floor	20%

BCBS Guidelines – Standardized Approach Banks	
Hierarchy	(1) RBA (2) 1250%
Risk Weight Floor	20%

Assigning Risk Weights to Securitization Exposures – Advanced Approaches Banks

Final U.S. Basel III Rule – Advanced Approaches Banks	
Hierarchy	(1) SFA (2) SSFA (3) 1250% <i>*Under the Collins Amendment, U.S. Advanced Approaches Banks also have to calculate risk-based capital under the Standardized Approach to determine their capital floor</i>
Risk Weight Floor	20%

BCBS Guidelines – Advanced Approaches Banks	
Hierarchy	(1) RBA (2) IAA (3) SFA (4) 1250%
Risk Weight Floor	7%

Changes in Final Rule

- The standardized risk weights for residential mortgage loans remain unchanged from the existing Basel I rules.
- The definition of resecuritization has been modified to exclude single bond re-REMICs and other securitizations of a single underlying exposure.
- Parameter W in the SSFA (the adjustment parameter for 90 day or > delinquent assets) will exclude contractual deferrals of payments of principal or interest on (a) all federally guaranteed student loans and (b) other consumer loans (including non-federally guaranteed student loans) provided such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for deferral periods that are not initiated based on changes to a borrower's creditworthiness.

Industry Concerns Not Resolved in Final Rule

- The 1,250% maximum risk weight was not capped at the dollar amount of the relevant securitization exposure.
- A 1,250% risk weight is applied to the relevant securitization exposure when a bank fails to comply with the new due diligence requirements.
- The amount of an off-balance sheet commitment that is not made to an ABCP conduit is the notional amount of the exposure and is not reduced to the available asset base.
- KG for purposes of determining the SSFA has not been made more risk sensitive.
- The minimum risk weight for securitization exposures under both the Standardized Approach and the Advanced Approach is 20%.
- Pool-wide inputs may not be used to determine KIRB for purposes of the Supervisory Formula Approach.
- Securitization exposures in which a small percentage of the underlying exposures constitute securitization exposures are not excluded from the definition of resecuritization.

Potential Impact of Basel Consultative Papers on Capital for Securitization Exposures

- BCBS published a consultative paper containing proposed revisions to the securitization framework in December 2012 and published a second consultative paper revising those proposals in December 2013 (collectively, the **BCBS Consultative Papers**). The BCBS Consultative Papers propose several major changes to the Standardized Approach and Internal Ratings-Based Approach securitization frameworks under the BCBS Guidelines.
- **Major Proposed Revisions:**
 - Revised hierarchy for assigning risk weights to securitization exposures to be established as set forth in the BCBS Consultative Papers
 - Revisions to SSFA and SFA set forth in BCBS Consultative Papers would result in higher risk weights for equivalent securitization exposures as compared to the SSFA and SFA set forth in the Final U.S. Basel III Rule
 - Under both the Standardized Approach and the Advanced Approaches, the BCBS Consultative Papers would apply the same 15% risk weight floor to all securitization exposures

BCBS Consultative Papers: Revised Hierarchy

Internal Ratings Based Approach



External Ratings-Based Approach (if ratings permitted in jurisdiction)

Standardised Approach

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