15 January 2025

IACPM – Response to UK PRA Consultation Paper CP13/24
Section 3 – Securitisation requirements

The IACPM is an industry association established to further the practice of credit exposure management by providing an active forum for its member institutions to exchange ideas and take collective action. Credit portfolio managers have a unique and evolving role in today's financial markets, and the IACPM offers an excellent forum through which these issues can be identified, understood and addressed. The Association holds annual conferences and regional meetings, conducts research on the credit portfolio management field, represents its members before regulatory and administrative bodies around the world and works with other organizations on issues of mutual interest relating to the measurement and management of credit portfolio risk. Currently, there are 154 financial institutions based in 32 countries that are members of the IACPM. More information is available at www.iacpm.org.

As with the IACPM' s response to the PRA's discussion Paper DP3/23, this response the PRA Consultation Paper CP13/24 focuses of the questions which are relevant for on balance-sheet securitisations executed by banks for portfolio risk mitigation or capital management. This response letter reflects the views of our member banks, investment firms and insurers involved in these risk sharing transactions. Finally, the IACPM annual private surveys on funded and unfunded SRT (banks/insurers) are ongoing and will be available for discussion with the PRA in the second quarter of 2025.

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

IACPM members welcome the PRA's proposals to make changes to the p-factor in the SEC-SA methodology.

We set out our concerns in relation to the impact which the Basel 3.1 Output Floor will have on SRT securitisations executed using the SEC-IRBA methodology in detail in our response to the PRA's Discussion Paper DP3/23 (the "DP3/23 Response"), and we attach that response as an Appendix to this response. In the DP3/23 Response we explained in detail the benefits which SRT securitisation has for the stability of the UK financial system and why a reduction in the level of SRT securitisation would be an undesirable outcome for the wider UK economy. All of those considerations remain as valid today as they were a year ago.

In the DP3/23 Response we also explained why the Basel 3.1 Output Floor has an outsized, and in our view, unintended, impact on SRT securitisations, and why the p-factor used in the SEC-SA methodology significantly amplifies that impact. We also explained that in order for SRT securitisation to be a cost effective and viable as a portfolio management tool for IRB Banks, it would be necessary to apply a p-factor in the range of 0.3 to 0.5 when applying the SEC-SA methodology for the purposes of the Output Floor calculations.

On the specifics of the proposal, we note that the p-factor in the SEC-SA would in all cases be floored at 0.5 for non-STS securitisation, and 0.3 for STS securitisation. Given that the PRA is proposing to use the same formula to calculate the p-factor for the SEC-SA as applies to calculate the p-factor for the SEC-IRBA, including using the same values for the parameters A, B, C, D and E, it is not clear why these floors have been chosen, rather than applying the floor of 0.3 which applies to the p-factor for both STS and non-STS securitisation under the SEC-IRBA. The impact of this is particularly pronounced for UK banks because, unlike in the EU, the STS regime does not apply to synthetic SRT securitisation in the UK. As such, for the vast majority of SRT securitisations in the UK, the p-factor would be *floored* at 0.5, in contrast to the position in the EU where the p-factor used in the SEC-SA for Output Floor purposes would be *no more than* 0.5, and will in many cases be 0.25 where the securitisation meets the STS requirements. this continues to put UK banks at a competitive disadvantage compared with their EU competitors, without there being any indication that SRT securitisation poses a prudential risk to the stability of UK banks.

While we urge the PRA to consider once again our response to Question 7 in the DP3/23 Response, we understand that the PRA has no appetite to extend the STS regime to synthetic securitisation at this time. However, applying the same 0.3 floor to the p-factor under the SEC-SA as applies under SEC-IRBA would significantly improve the viability of SRT securitisation for UK banks operating under the Standardised Approach. As can be seen from the experience in the EU, the p-factor of 0.25 for the SEC-SA in STS securitisations has been crucial to the ability of Standardised banks to make use of synthetic securitisation of a portfolio and capital management tool. In addition, for IRB banks, this small change would come closer to addressing fully our concerns about the impact of the Basel 3.1 Output Floor for SRT securitisations executed under the SEC-IRBA

More specifically, we note that the lack of a exposure type specific LGD for auto loans will be particularly penal for that asset class, as it will mean banks will need to apply the fallback LGD of 100% and this will erode any value in the p-factor reduction. We urge the PRA to consider including a specified LGD for his asset class which is more reflective of the losses experienced on such loans.

Finally, while we note the PRA is not currently proposing any changes to the SEC-IRBA, we disagree with the PRA's assertion in paragraph 3.18 that the level of the p-factor floor under the SEC-IRBA is appropriate. IACPM members generally consider that the entire securitisation framework is overly conservative for transactions executed on own banks' assets, and the level of non-neutrality imposed on the senior tranches is disproportionate to the actual level of risk associated with those tranches, notably the absence of model and agency-related risks.

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

IACPM members acknowledge that the current treatment of mortgage loans which benefit from partial credit protection under the MGS and other similar schemes produces an anomalous result, and that changes should be made to the current treatment. However, we disagree that the PRA's proposed solution is the correct way to address the issue.

In our view, the MGS, and other similar schemes, should not be considered to be securitisations in the first place. The nature and effect of such schemes is fundamentally different from the type of arrangements which are intended to be captured by the definition of securitisation set out both in the Basel Framework and the UK Securitisation Rules. Rather, they should be treated as a form of credit risk mitigation in respect of the individual loans protected by the scheme. Consequently, the impact of such schemes on the capital treatment of the protected loans should be dealt with through the credit risk mitigation framework rather than the securitisation framework. This would more accurately reflect the loan-by-loan nature of the protection provided by the schemes.

Treating these schemes as securitisations also creates problems where the originator wishes to include the relevant mortgage loans in another securitisation (whether traditional or synthetic), because this means the resulting securitisation is arguably a resecuritisation. Again, we do not think that this is the type of transaction, which is intended to be captured as a resecuritisation, and it should be possible for the originator to securitise loans benefiting from protection under the MGS or other similar schemes.

As to the substance of the PRA's proposals, assuming they were made outside of the securitisation framework, we consider that the proposals for exposures under the Standardised Approach are logical. The proposals in relation to IRB exposures are, however, understating the impact of the protection, and we consider that a better

approach would be to allow for adjustment in the RWA in a way which better reflects the effect of the protection provided (along the lines of the parameter substitution method).

We note that the PRA has indicated that it is open to suggestions as to alternative ways to address this issue. As there are a number of possible ways in which the credit risk mitigating effect of such schemes could be taken into account through the credit risk mitigation framework, outside of the securitisation framework, we would welcome the opportunity for a further discussion with the PRA in this regard.

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

IACPM members welcome the PRA's proposal to allow the use of unfunded credit protection for synthetic SRT securitisation. As we discussed in our response to Questions 8–10 of the DP3/23 Response, unfunded credit protection provided by private sector entities—primarily insurers—has become an important part of the EU SRT market, and it is particularly well-suited to certain types of portfolios.

For the purpose of this response, we assume that the PRA is not concerned with the risk of public sector entities which qualify for a 0% risk-weighting under the CRR—such as the UK government of IFIs, such as the International Finance Corporation—failing to pay losses in an unfunded SRT securitisation. Our comments below are therefore focussed on unfunded protection provided by private sector entities, which are invariably insurance or reinsurance firms.

We note the PRA's comments in paragraph 3.66 around the risk of late or non-payment by protection providers and the risk that a downgrade of an unfunded protection provider may mean that it is no longer eligible to provide unfunded protection. We make the following observations in this regard.

First, as discussed in our DP3/23 Response, the private sector unfunded SRT market has now been operating effectively in the EU for several years (the first such transaction was executed 2018) with insurers paying losses in a timely manner. This is consistent with the experience of the broader loan-by-loan credit insurance market, where out of a total number of 578 claims posted between 2007 and 2020, for a total amount of USD 3,75 billion, only 15 claims have been rejected by insurers due to the non-fulfilment by the Insured Entity of an obligation or term under the policy within the Insured’s control The position is even clearer since then, with the data for 2021 to 2023 as follows:

	2021	2022	2023
Claims paid	USD 1,010,242,049	USD 529,534,436	USD 537,005,378

Number of claims	140	190	227
Compromised claims	0	0	0

In addition, as we explained in our response to Question 10 in the DP3/23 Response, the terms of the unfunded credit protection contracts used in SRT securitisation are very different from those used in credit insurance more generally and provide protection providers with far fewer opportunities to challenge their liability for losses incurred on the relevant tranche. For example, the duty of fair presentation is generally excluded or watered down, there are no exclusions and there are no insurance law warranties, all of which otherwise give insurers some limited opportunities to avoid paying claims under insurance law. Similarly, the originator will have more control over the process for determining claim amounts payable than is typically the case in single-name credit insurance. All of this means that arguably the concern around late- or non-payment is even less warranted for SRTs than for more traditional loan-by-loan credit insurance (although we are by no means implying there should be a concern for single-risk exposures).

Given that the protection providers are invariably highly rated prudentially-regulated insurers or reinsurers, this also means that the risk of non-payment from a pure credit perspective is extremely low, and this risk is adequately taken into account in the risk-weight which the originator is required to apply in respect of that insurer or reinsurer under the CRR.

Secondly, the risk that an insurer or reinsurer would be downgraded to a level at which it would no longer be an eligible protection provider for a SRT securitisation is low. Even if that were to occur, this does not necessarily mean that the bank will suffer a loss. Rather, in those circumstances, the bank would terminate the contract with the relevant insurer and seek to execute a replacement credit protection arrangement with a different protection provider, which may include other (re)insurers in the syndicate. Indeed, IACPM's own research indicates that 89% of unfunded SRT securitisations involve more than one insurer, with the average participation by a given insurer being 35% of the relevant tranche, meaning in most cases there is already at least one potential replacement counterparty with knowledge of the transaction. In addition, this risk is mitigated by the low probability of a material downgrade in the first place, the fact that credit risk represents a very small proportion of an insurer's overall diversified portfolio, and also the large and growing capacity within the insurance sector and funded investor market for these transactions, thus is not itself a reason for prohibiting the use of unfunded protection in the first place.

For completeness, we also note that the EU has at least partly addressed this risk by removing the minimum rating requirement for credit protection provided by regulated

insurers. Thus, while the risk-weight which the originator would need to apply to its exposure to the insurer would increase following a downgrade, and thus the originator would need to hold more capital to reflect that, this does avoid the cliff-edge effect of the originator losing the benefit of the SRT securitisation immediately upon the downgrade. IACPM members urge the PRA to consider making a similar change to the UK rules. When coupled with a contractual right for the originator to terminate that insurer's participation upon a downgrade, this provides the originator with flexibility to execute a replacement transaction at the time when market conditions are most favourable, while also ensuring that it is holding additional capital in the interim reflecting the increased risk of the downgraded protection provider.

Nevertheless, members do acknowledge that the nature of unfunded protection does require some differences in how the originator goes about assessing the effectiveness of the risk transfer over the life of the securitisation, and that this would be reflected in the SRT assessment process. Members therefore welcome the PRA's proposal to provide clarity around its supervisory expectations and stress testing to assist firms. In this regard, we note that the PRA has not actually provided the detail of what these expectations may be, and we would welcome the opportunity to discuss this with the PRA further.

Proposal 4: Other changes to supervisory expectations relating to securitisations

IACPM members have some practical concerns with the proposals set out in paragraph 3.75 of the CP with the requirement that oversight and approval of the features that affect commensurate risk transfer should be performed by SMF 2. In many cases, this will be the Chief Financial Officer (as the person who has responsibility for management of the financial resources of the firm, which includes capital management activity). This potentially leads to two issues.

First, this creates a bottleneck with the deal process, given the sign-off seniority required. Some level of proportionality would be appropriate here. For example, a lower level of sign-off could be required where the impact of the transaction on the bank's CET ratio will be below a certain level.

Secondly, some clarity is needed on the level of oversight required to satisfy the standard. The calculations that affect commensurate risk transfer are complex nature and the SMF will need to rely on subject matter experts within the bank's control and governance framework. It appears from the proposed change that the SMF would now be expected to demonstrate expert knowledge of these calculations, which will only be realistic to a point. Again, a degree of proportionality would also be appropriate in this regard.

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

[It is not proposed to respond to this proposal.]

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

IACPM members disagree with the proposal to increase the risk-weight for the undrawn portion of cash advance facilities in the context of a securitisation from 0% to 10%. While we acknowledge that there may be factors that discourage firms from exercising their rights to cancel such facilities, in our view this proposal fails to take into account the other structural features referenced in Article 248(1)(b) of the CRR in a securitisation which mean that the risk of such facilities bearing losses is extremely low.

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

IACPM members support these proposed changes, which address some known deficiencies with the way the existing CRR simply cross-references Part Three, Title II, Chapter 4 of the CRR without taking into account the fact that a securitisation position does not have a PD or LGD, regardless of which methodology is being applied. These changes also address the discrepancy in the existing Article 249(4) which only permitted an ineligible unfunded protection provider which also provided funded credit protection where that provider was a SSPE.

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

[It is not proposed to respond to this proposal.]

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

[It is not proposed to respond to this proposal.]

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

[It is not proposed to respond to this proposal.]

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

[It is not proposed to respond to this proposal.]

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

[It is not proposed to respond to this proposal.]

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

IACPM members agree with these proposed changes.

In addition, we also suggest clarifying that the nominal amount of the underlying exposures in default should be limited to the maximum remaining defaulted amount which has not already been applied to reduce the notional amount of the securitisation tranches. For example, for an exposure with a defaulted balance of £1,000, if an initial loss of £300 has already been applied to reduce the balances of the tranches, and total recoveries have already been received of £500, the nominal amount for the purposes of the W-parameter should be limited to the remaining £200.

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

IACPM members are concerned that the proposed changes to Article 268 will not actually achieve a lower capital cap than is currently available under the existing Article 268. This is because, by calculating the component of the cap by reference to the nominal amount of each tranche, the effect of the proposal is to apply a risk-weight of 1250% to the portion of each tranche corresponding to {100% – U}. To avoid this outcome, we propose that Z(i) should be defined as the capital charge associated with the relevant tranche.

Proposal 15: Notification of breaches of certain securitisation requirements

[It is not proposed to respond to this proposal.]

Proposal 16: Other minor changes

[It is not proposed to respond to this proposal.]

We appreciate the opportunity to share our comments on the Consultation. If you have any questions or would like additional information, please contact the undersigned.

Yours sincerely,

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International Association of Credit Portfolio Managers