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# EBF response to BCBS consultation on *Technical amendment: Capital treatment of securitisations of non-performing loans*

## General comments

While non-performing loans (NPL) ratios have been continuously and significantly reduced since 2014, Covid-19 is expected to reverse the current trend. One of the ECB estimates on loan losses shows that these could increase to 3% of total loans to NFCs[1], i.e. EUR 160bn. Together with existing NPL stock (EUR 543bn as of Sept 19[2]), the total is expected to rise substantially in excess of EUR 0.7tn.

Against this background it is essential that measures are taken to mitigate the expected sharp rise in NPLs in Europe. Securitisation could be an interesting instrument to off-load NPL portfolios, thereby freeing up capital and increasing banks' capacity to lend to the real economy. As such the European Banking Federation (EBF) supports the concept of NPL securitisations and welcomes the work of regulatory institutions on the topic of NPL securitisations, notably the recent focus of the European Commission (EC) on this topic as part of the "recovery package". Regarding the proposals of the Basel Committee, however, we would like to highlight our concerns below as well as some suggestions as how those could be addressed.

## The Basel Committee should build on the technical work already being done in BCBS member jurisdictions

The current securitisation framework[3] applying to performing exposures is already non-neutral from a capital point of view because the sum of own funds requirements applying

[1] ECB, Financial Stability Review, May 2020, p.59. Sensitivity analysis of Euro Area bank's loan losses before policy measures as a consequence of NFC cash-flow disruptions. 3% is the lower bound of the range of estimates. Range of estimates based on four scenarios, two of which assume a reduction of each NFC's cash flows by 50% and 100%, respectively, for a period of three months, and two of which assume that euro area GDP declines in 2020 by about 8% and 12%

[2] ECB, Annual Report on supervisory activities, 2019, p.22. Total volume of NPLs held by Euro Area SIs (Significant Institutions).

[3] Regulation 2017/2401 (the "Securitisation Regulation") and Regulation 575/2013 (the "CRR")

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to the whole securitisation structure (i.e. to all tranches) exceeds the ones that apply to the underlying portfolio[4].

As highlighted by the EU's European Banking Authority, in their October 2019 opinion, the capital non-neutrality of the securitisation framework is even more significant with regards to NPL securitisation transactions. This results from the specificity of the underlying assets which are "both economically and financially distinct from performing exposures".

Indeed, because the underlying pool of NPL securitisation is composed of defaulted exposures, the risk taken by investors is not credit risk (this risk has already materialized) but the possibility that the workout process (collections) will not cover NPLs' net value or purchase price.

To cover that risk, NPLs are securitised at a discount to the outstanding value of the loans, which is referred to as the "non-refundable purchase price discount" ("NRPPD"). Being irrevocably absorbed by the originator at the time of the sale (i.e. the originating bank cannot benefit from any collection upside), the NRPPD plays a credit enhancement role (or loss-absorbing effect).

Yet, as currently designed, the SEC-IRBA and the SEC-SA do not explicitly and fully take into account the NRPPD credit enhancement role. In their October 2019 opinion, the EBA identified this issue, noting that "the regulatory capital requirements on holdings of NPL securitisations under the CRR […] produce seemingly disproportionate capital charges when compared to relevant benchmarks"[5].

We thus support the avenues proposed by the EBA in their 2019 opinion paper[6], notably:

- The review of the inputs to the formulaic approaches (SEC-IRBA and SEC-SA) to better reflect the loss-absorbing effect of the NRPPD in NPE securitisations;
- The recalibration of the p-factor for NPL securitisations for the purposes of Articles 259(1) and 261(1) of the CRR; and
- Clarification allowing immediate application of a "full net basis calculation" for the purposes of applying the caps within Article 267(3) & 268(1) CRR, under the SEC-IRBA to NPL securitisations and applying the 100% risk weight caps within Article 267(2) & 268(1) under the SEC-SA where the NRPPD is at least equal to 20% or in the case of the originator was able to apply that same risk weight on the underlying portfolio pre-securitisation[7].

More specifically, with regards to the SEC-SA, we believe that the delinquency factor "W", which is designed to capture the credit deterioration of performing pools, is not adapted to non-performing pools that consist of assets already in default with no risk of further unexpected delinquencies. A simple fix would be significantly lowering the "W" factor in the case of NPL which would go a long way in correcting the punitive treatment of NPLs under SEC-SA and facilitate the development of NPL securitisation.

Below we present two illustrative options as to how a recalibration of the parameters could be done:

[4] The own funds requirements applying to the underlying portfolio cover the sum of both the expected and unexpected loss.
[5] See page 24 of the EBA 2019 Opinion paper.
[6] EBA-Op-2019-13, October 23, 2019
[7] See page 7 & 8 of the EBA Opinion paper

Option 1 for recalibration:

The simulation below, based on the same securitisation structure as the one used by the EBA in their 2017 Discussion Paper, aims to show the extent to which the current SEC-SA does not reflect the underlying risk of securitisation tranches and how the recalibration of both the p-factor and the w-factor could tackle this issue. In this example, although the NRRPD is 79%-thick, the risk-weight calculated under SA for senior tranches is greater than 500%, which is considerable. Setting the w-factor at 0.35 and the p-factor at 0.5 for instance would help achieving greater risk-sensitivity.

| | | | | | | | | EBA figures | | | Simulations | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Tranches | | | | | T | D | A | **SEC ERBA** | **SEC SA** | **SEC IRBA** | SEC-SA | SEC SA (customisable) |
| A | 182.76 | 43.50% | A1 | A | 9,1% | 100,0% | 90,9% | 63% | 505% | 426% | 505% | 40% |
| B | 16.81 | 4.00% | Baa3 | BBB | 0,8% | 90,9% | 90,0% | 136% | 557% | 532% | 557% | 53% |
| C | 14.71 | 3.50% | B1 | BB | 0,7% | 90,0% | 89,3% | 273% | 566% | 552% | 565% | 55% |
| Other | 205.87 | 49.00% | NR | NR | 10,3% | 89,3% | 79,0% | 633% | 719% | 70% | 633% | 76% |

| | |
|---|---|
| **W factor** | 0,35 |
| **P factor** | 0,5 |

Source: based on EBA-DP-2017-03, 19 September 2017, figure 24, p99.

As mentioned in the EU's High-level Forum (HLF) on Capital Markets Union (CMU) recommendations, the non-neutrality of the capital regime, intentionally introduced primarily through the supervisory "p" factor and the risk-weighting floor of senior tranches, is disproportionate. A p-factor of 0.5 instead of 1 is recommended for SEC-SA for non-STS and 0.25 for STS in general in the CMU HLF. Thus, proposing a p-factor of 0.5 in the specific case of NPL securitisation is consistent with the CMU HLF recommendations.

Regarding the w-factor, there are several points to consider for the recalibration:

- W was designed to make the SEC-SA formula risk sensitive for performing pools having larger delinquencies than initially expected. It is not designed for NPLs where the notion of delinquencies does not exist. By extending the reasoning to NPLs, it could be viewed as capturing the portion of the assets that will not recover their expected value under the business plan in an unexpected stress scenario.
- In the formula for Ka, the portion of the portfolio in default (w) is effectively subjected to a risk-weight of 625% (0.5*1250%), whereas similar unsecuritised NPL exposures are subject to a 100% or 150% risk weight, adding considerable non-neutrality. "W" should be multiplied by a factor of [0.1-0.2] instead of 0.5 for NPLs

Taking the above points into account, we propose a w-factor of 0.35 to illustrate how it could be recalibrated more appropriately for NPL securitisations.

Option 2 for recalibration:

- W-factor = 0% at closing considering that the portfolio purchase price is a "market price" – this is determined by a third-party investor according to its recovery expectations (Business Plan) with a meaningful discount vs nominal value

- In order then to track the underperformance, we would insert a link between W-factor over time and the Cumulative Collection Ratio ("CCR" - i.e. ratio between cumulative actual recoveries from closing date up to the current payment date and cumulative expected recoveries in the Business Plan from closing date up to the current payment date). W = MAX (0%, 1- CCR)
- P-factor = 0.85
- Cap of the RW to 100% for the senior tranche

We note that BCBS has worked on the same issues as a consultation is currently on-going. It is regrettable that the BCBS is taking a very different approach to what was proposed by the EBA although Europe came prior with some suggestions which failed to be taken into consideration at BCBS level.

First, the consultation paper does not propose any recalibration of the p-factor or of the inputs to SEC-IRBA or SEC-SA to reflect the NRPPD loss-absorbing effect. For instance, and although this had not been proposed by the EBA, the conceptual flaw in the SEC-SA formula resulting from the delinquency factor "W" that captures credit deterioration is not addressed.

In addition, instead of a 100% cap, the paper proposes a fixed 100% risk weight (RW) for the senior tranche. Not only does this proposal negate the principle of securitization waterfall, but it also makes securitisation unattractive from a capital relief point of view. Indeed, in a typical securitisation transaction, the senior tranche is very thick (e.g. ~80% to ~90% of the structure) and the risk-weight applicable to the underlying portfolio is – under SA – equal to 100% (150% if provisions cover less than 20% of the portfolio). Under the BCBS proposal, a 100% risk-weight would apply to the senior tranche post-securitisation, i.e. the same than the one applying to the underlying portfolio pre-securitisation. In other words, for an originating bank that would retain senior tranches, the capital relief would be only driven by the proportion of securitisation tranches transferred to the investors.

Also, the BCBS proposes a floor on other tranches, which had not been proposed by the EBA. The EBF holds the view that it is unfortunate that the BCBS is not aligned with those proposals, as we in general consider a large part of the EBA's proposal to be better suited to addressing the problem of NPLs.

As a result, the proposed BCBS standard, unless modified following the current consultation running until August 23, 2020, would not be a viable basis to support the development of NPE securitization in Europe, as a response to the Covid crisis.

**The Basel proposal will lead to reduced sales prices of NPL for institutions, hindering NPL reduction**

Strong investor demand and financing appetite have supported the deleveraging of the European banking sector through the sale of loan portfolios, mostly NPLs.

This has been partially aided by government-backed schemes, national asset management companies, or certain developments in the legal/regulatory space. External servicers have become more effective in working out NPL portfolios and have often been financially backed by private equity firms and other regular NPL portfolio buyers.

Private equity firms are among the top buyers of NPL portfolios who typically require leverage through privately arranged financing from institutions (i.e. mainly banks). Financing is usually structured as recourse only to the NPL portfolio – private senior securitisation position.

Investor banks have been and need to continue to be the catalyst to the NPL disposals, as (i) banks provide standalone bilateral private term financing to the buyers or (ii) finance the acquisition for a period of time before structuring a public securitisation with all or a subset of the NPL portfolio financed (the "easier" / "cleaner" NPL or reperforming loan (RPL) assets to place in capital markets).

Banks are also the underwriters of larger financings ahead of a syndication into a wider investor base (private securitisations sold to other sophisticated investors such as other banks, asset managers, credit/pension funds etc).

The Basel proposal would result in a minimum risk weight of 100% that is likely to lead to higher financing charges and consequently materially reduced sale prices for institutions seeking to sell NPL portfolios. Higher risk weights for the financing institutions will lead to a significant increase in the senior financing margin (potentially to more than double in the event of the Basel proposal being implemented). Lower sale prices will lead to: (i) higher provisions / losses for the selling institution; or (ii) no sale leading to a failure in reducing NPL level for the institution.

## The Basel proposal is not risk sensitive

In our view, the Basel proposal does not provide the support needed to tackle a potential future increase in NPL ratios. The Basel proposal is a non-transversal approach that breaks any linkage between the risk of a portfolio and that exhibited by a senior tranche.

- It would take away the risk-sensitivity of the methodology for determining the risk weight, a key principle behind the redesign of the securitisation framework including the re-prioritisation of the hierarchy of approaches. Although the Basel proposal does not prohibit explicitly the use of advanced IRB parameters as inputs for the SEC-IRBA for all NPL securitisations (but puts a ban on the use of foundation IRB parameters only), the requirement of applying a fixed 100% risk weight to the senior tranche and a risk weight floor of 100% in all other cases, would actually harm the risk sensitivity of risk weights.
- Due to the usually high level of non-refundable purchase price discount (NRPPD), the discount for NPLs which are securitized is significantly higher than the provisions for exposures that are kept on the balance sheet. This leads to a significant decrease in risk sensitivity, as it eliminates the entire benefit of securitization, breaks the connection between on-balance sheet criteria and those for securitised exposures and further exacerbates the non-neutrality between on balance sheet exposures and securitised exposures. Moreover, this proposal introduces a bias towards securitized exposures, which would assume that securitized NPLs are always more risky than non-securitized exposures.
- It would take away the credibility, expertise and risk sensitivity brought in also through external rating agencies. Such loss of risk sensitivity could lead to less data collection and analysis on NPLs which could stunt the development of the NPL securitisation market.
- In addition, while we have not seen the QIS, from our knowledge of today's European market we struggle to see evidence that supports the Basel proposal. Therefore, we remain sceptical about the risk sensitivity of the Basel proposals.

**Remaining challenges for the regulatory framework**

We would like to highlight that NPL securitisation faces a number of challenges that cannot be fully addressed in the context of this consultation:

- Selling NPLs portfolios in most cases leads to a loss for originating banks as investors require a significant discount resulting, by design, from a high targeted internal rate of return, high funding costs and from the unbalance between supply and demand leading to undue transfer of value from the banking sector to investors (often non-EU investor based).
- Out of an already narrow investor base, various investors have disappeared during the health crisis and it is unlikely that investors' appetite will grow in the near future considering the uncertainty of the economic recovery and of NPL work out perspectives.
- Securitisation transactions have been mostly conducted so far in countries with high levels of NPLs, under supervisors' pressure to accelerate the implementation of NPL reduction strategies, or by banks that took the decision of not managing all their NPLs internally.
- In general, the current regulation is overly conservative for regulatory capital treatment, as is also reflected in the BCBS' proposals.
- In specific cases, NPL securitisation transactions have proved efficient when performed under a state-sponsored mechanism that improves their global risk-return profile (thanks to a guarantee on senior tranches for instance). It is likely that such enhancements remain necessary to ensure the economic viability of NPL securitisation.

As long as these challenges persist, NPL securitisation will not fully play its role in banks' NPL reduction. This is why it is all the more important for the BCBS to adopt a framework where risk-weights actually reflect the underlying risk of NPL securitisation tranches. With regards to senior tranches, it must be reminded that the NRPPD, together with junior and mezzanine tranches, absorb the risk of NPL collection, the unexpected loss and the expected loss of the whole portfolio; in addition, the conservative p-factor more than caters for agency risk. It is also to be noted that the NRPPD provides for a comfortable margin of security due to the very significant expected internal rates of return of private equity funds that invest in NPL securitisation. As a result, the risk-weighting of the BCBS proposal should reflect the fact that senior tranches bear minimal residual risk.

## Detailed comments

### Paragraph 45.1

"A non-performing loan securitisation (NPL securitisation) means a securitisation where the underlying pool's variable W, as defined in CRE41.6, is equal to or higher than 90% at the origination cut-off date and at any subsequent date on which assets are added to or removed from the underlying pool due to replenishment, restructuring or any other relevant reason."

EBF comments:

We recommend that the definition of "W" and the underlying pool of exposures of an NPL securitisation should also include any enforced collateral that secured a non-performing loan including foreclosed real estate held / owned (directly, beneficially or otherwise) by the securitisation prior to its sale.

Furthermore, with regards to the SEC-SA, the delinquency factor "w" is designed to capture the credit deterioration of performing pools and is thus not adapted to non-performing pools that consist of assets already in default with no risk of further unexpected delinquencies.

- Setting its value at 0% in the case of NPL securitisation would mitigate the conceptual flaw of this factor that increases the amount of capital required for the underlying portfolio as an input to the SEC-SA formula, leading to a redistribution of higher risk-weights on all tranches, which is not justified from a theoretical point of view. A 0% w-factor would go a long way in correcting the punitive treatment of NPLs under SEC-SA and would effectively facilitate the development of NPL securitisation.

That being said, a 0% w-factor would quickly bring risk-weights on the most senior tranches down to the 15% floor (which, from a prudential point of view, is sound). Yet should the regulator wish to maintain a higher level of conservatism for NPE securitisations, a higher floor for senior tranches could be introduced (e.g. 20% or 25%).

In that context, the EBF would also like to refer to the two options presented on page 3 and 4 of this paper regarding a potential recalibration.

### Paragraph 45.2

"National supervisors may provide for a stricter definition of NPL securitisations than that laid out in CRE 45.1. For these purposes, national supervisors may:

(1) raise the minimum level of W to a level higher than 90%; or

(2) require that the non-delinquent exposures in the underlying pool comply with a set of minimum criteria or preclude certain types of non-delinquent exposures from forming part of the underlying pools of NPL securitisations.

Without prejudice to the foregoing, national supervisors should scrutinise NPL securitisations to prevent any instances of regulatory arbitrage. In particular, national supervisors should preclude transactions executed with the main purpose of reducing the capital charge on the non-delinquent exposures in the underlying relative to the 100% risk weight on the senior exposure to the NPL securitisation referred to in CRE45.3."

EBF comments:

The Committee allows the NCAs to implement stricter criteria. Yet, in our view, any definition – adopted by national supervisors – should ensure that the percentage of defaulted assets in the portfolio would remain strictly below 100%, given the existence of

NPLs transaction with a small % of bonis underlying. The goal is to limit the NCAs' discretion in defining too high thresholds.

By referring to CRE 41.6 in the Basel Framework, the amendment proposes to define the percentage of defaulted asset in the securitisation and, therefore, the "qualification" of the securitisation as an NPL, based on the "W" parameter of the SEC-SA approach. As per CRE 41.6 and 41.7 "*Delinquent underlying exposures are underlying exposures that are 90 days or more past due, subject to bankruptcy or insolvency proceedings, in the process of foreclosure, held as real estate owned, or in default, where default is defined within the securitisation deal documents*". The fact that default could be defined within the securitisation deal documents could allow banks to define delinquency and default of underlyings also in the securitisation deal documents and to manage the percentage of assets that should be considered in default for the NPLs securitisation qualification. In our opinion, this flexibility could turn into a strong incentive for some banks to enlarge the definition of default in order to benefit from the special treatment. Instead, we propose the introduction of a clear reference to the general Basel credit risk framework and the related definition of default ensuring a playing level field in the "qualification" of NPL securitisations.

### Paragraph 45.3

"A bank should assign a fixed 100% risk weight to the senior tranche of NPL securitisations instead of applying the hierarchy of approaches referred to in CRE40.41 to CRE40.47 and the look-through approach referred to in CRE40.50 when the following three conditions are met:

(1) the NPL securitisation is a traditional securitisation;

(2) the underlying pool of exposures was securitised at a discounted price on the outstanding amount of the pool of exposures and the discount is not refundable to the originator or original lender (the non-refundable purchase price discount or NRPPD); and

(3) the NRPPD referred to in (2) was equal to or higher than 50% of the outstanding amount of the pool of exposures as of the origination cut-off date;"

EBF comments:

We recommend the following changes:

- In relation to the hierarchy of approaches:
  - For SEC-IRBA remove the fixed 100% risk weight and the NRPPD of at least 50% threshold.
  - For SEC-SA, reduce the NRPPD from 50% to 20%.
  - Fixed 100% risk weight disapplied for SEC-ERBA.
  - A 100% RW cap, instead of the fixed 100% RW for the senior tranche.
    - Not only does the BCBS' proposal negate the principle of securitization waterfall, but it also makes securitisation unattractive from a capital relief point of view. Indeed, in a typical securitisation transaction, the senior tranche is very thick (e.g. ~80% to ~90% of the structure) and the risk-weight applicable to the underlying portfolio is – under SA – equal to 100% (150% if provisions cover less than 20% of the portfolio). Under the BCBS' proposal, a 100% risk-weight would apply to the senior tranche post-securitisation i.e. the same than the one applying on the underlying portfolio pre-securitisation. In other words, for an originating bank that would

retain senior tranches, the capital relief would be only driven by the proportion of securitisation tranches transferred to the investors.

- In relation to the look-through approach:
    - Adopt the EBA's opinion[8] summarized as:
        - SEC-IRBA: application of a "full net basis calculation" for the purposes of applying the caps within Article 267(3) & 268(1) CRR, under the SEC-IRBA to NPL securitisations; and
        - SEC-SA: applying the 100% risk weight caps within Article 267(2) & 268(1) under the SEC-SA where the NRPPD is at least equal to 20%.

Additional comments:

- It is important to recalibrate the p-factor for NPE securitisations[9], as recommended by the EBA. Such recalibration should be performed in conjunction with the one of the w-factor.
- NRPPD of 20% would align to the application of 100% for on-balance sheet NPL under Article 127(1)(b) and therefore maintaining the key principle within Article 267(1) "as if the underlying exposures had not been securitised". In case the 50% threshold for NRPPD be maintained, we would like to remark the following: "Qualified" NPL securitisations are defined as those where the non-refundable purchase price discount (NRPPD) is equal to or larger than 50% of the outstanding amount of the NPLs. In our opinion, a variable or a differentiated threshold for securitized assets should instead be considered, given the huge difference in the risk (and pricing) of secured and unsecured NPLs.
- The amendment refers to a nominal or outstanding value of the NPL portfolio, indistinctly. However, in order to avoid confusion between the accounting value of the exposure and the effective credit claim, more clarity should be provided. Usually, prices are reported referring to the former however reference to the latter would be – in our opinion - the most appropriate.

**Paragraph 45.4**

"A bank is precluded from applying the SEC-IRBA to an exposure to an NPL securitisation where the bank uses the foundation approach as referred to in CRE30.33 to calculate the KIRB of the underlying pool of exposures."

<u>EBF comments:</u>

We agree with this proposal given that in the foundation IRB only the PD (Probability of Default) is estimated, but for NPLs all PDs are equal to 1, the SEC-IRBA results being as analogous to the Securitisation Standardised Approach (SEC-SA) with the strange possibility to provide less stringent requirements.

**Paragraph 45.5**

"In all other cases, banks must follow the hierarchy of approaches referred to in CRE40.41 to CRE40.47 or the look-through approach referred to in CRE40.50. However, where an exposure to an NPL securitisation may be assigned a risk weight of less than 100% in accordance with these approaches, a risk weight floor of 100% should instead be used for that exposure."

<u>EBF comments:</u>

[8] See page 7 & 8 of the EBA Opinion paper
[9] Please see Articles 259(1) and 261(1) of the European Capital Requirements Regulation (CRR) for how this is planned in the EU context.

We recommend removing the 100% risk weight floor for the following reasons:

- A floor equal to 100% is only a potential further conservative measure that goes in the opposite direction of what the stated aim of the amendment is.
- The consultation document of the BCBS' technical amendment[10] states that recent observations highlighted potential miscalibrations of RWs in NPL securitisations. The introduction of a fixed 100% risk weight applicable to the most senior tranche of qualifying NPL securitisations does not ensure a reduction in RWs of the notes, and, in our view, would not contribute to correct the miscalibration of RWs. This is, for example, the case for senior notes, which are rated higher than BBB and which would receive a RW lower than 100% through SEC-ERBA. Another example is related to the case of SEC-IRBA or SEC-SA, where there could be cases were the RW obtained is lower than 100%. One example is a loan/liquidity facility provided to the SPV that is super senior in the capital structure and thin compared to the rest of the notes.
- The recalibration of the risk weighting formula would have been more effective.

### Paragraph 45.6

"An originator or sponsor bank may apply the capital requirement cap specified in paragraph CRE40.54 to the aggregated capital requirement for its exposures to the same NPL securitisation. The same applies to an investor bank, provided that it is using the SEC-IRBA for an exposure to the NPL securitisation."

EBF comments:

Additionally, "look-through" approach to senior securitisation exposures specified in paragraph CRE40.50 may be applied. Under both approaches, the expected losses should be calculated net of NRPPD and of any additional specific credit risk adjustments. More specifically, a "full net basis calculation" should be the preferred approach for the purposes of applying the caps under SEC-IRBA to NPL securitisations. A full net basis calculation means that both the "expected losses" and "exposure value" referred to in CRE 40.50 and "expected losses" referred to in CRE 40.52 should be net by the amount of the relevant NPL's NRPPD and, in the case of the originator, any additional specific credit risk adjustments. The same applies to an investor bank, provided that it is using the SEC-IRBA for an exposure to the NPL securitisation.

Rationale:

The caps for securitisations within CRE 40.54 and CRE 40.50 are designed to ensure consistency with the non-securitisation framework and as a safeguard against the overly conservative capital requirements on relevant positions that may result from the securitisation regulatory capital methods. Accordingly, the caps should enable the investor institution to apply to the relevant securitisation positions (the senior position in the case of the look-through approach) the same or substantially the same capital charges that it would apply to the underlying exposures as if these "had not been securitised", that is, as if the investor had a direct exposure to the underlying. Therefore, application of the "full net basis calculation" should be the preferred approach for applying the caps under the SEC-IRBA to NPL securitisations.

As stated also in the EBA opinion on NPE securitisations from October 2019, "[t]he NRPPD should be net in this manner to enable the direct exposure to the underlying portfolio that

[10] Basel Committee on Banking Supervision, Technical amendment: Capital treatment of securitisations of non-performing loans (d504), June 2020, page 1

the caps are predicated on, taking into account that the underlying exposures are transferred at inception to a securitisation SPV and the transfer at a discount has the effect of writing off the underlying exposures' expected losses and leaving a residual value subject to the risk that recoveries may be insufficient to repay that residual value (unexpected losses). A full net basis calculation meets the purpose of the caps as a safeguard against unduly high capital requirements because:

a) it results in largely the same risk-weighted exposure amounts that the investor institution would be required to hold on the NPEs should it had acquired them directly at the same discount level by application of Article 159 of the CRR; and
b) it prevents the overshooting of capital requirements that results from a gross basis calculation. Furthermore, it also prevents an undershooting of capital requirements that results from a partial net basis calculation, that is, where only the expected losses of the NPEs, but not their exposure value, is offset by their NRPPD."[11]

[11] See EBA Opinion (EBA-Op-2019-13), page 7

## About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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