Basel Committee on
Banking Supervision

CRE

Calculation of RWA for credit risk

CRE42

Securitisation: External-ratings-based approach (SEC-ERBA)

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Cross references updated due to the December 2017 Basel III standard coming into effect.

BANK FOR INTERNATIONAL SETTLEMENTS

External-ratings-based approach (SEC-ERBA)

42.1 For securitisation exposures that are externally rated, or for which an inferred rating is available, risk-weighted assets under the securitisation external ratings-based approach (SEC-ERBA) will be determined by multiplying securitisation exposure amounts (as defined in CRE40.19) by the appropriate risk weights as determined by CRE42.2 to CRE42.7, provided that the operational criteria in CRE42.8 to CRE42.10 are met.[1]

Footnotes

[1] *The rating designations used in Tables 1 and 2 are for illustrative purposes only and do not indicate any preference for, or endorsement of, any particular external assessment system.*

42.2 For exposures with short-term ratings, or when an inferred rating based on a short-term rating is available, the following risk weights will apply:

ERBA risk weights for short-term ratings — Table 1

External credit assessment	A-1/P-1	A-2/P-2	A-3/P-3	All other ratings
Risk weight	15%	50%	100%	1250%

42.3 For exposures with long-term ratings, or when an inferred rating based on a long-term rating is available, the risk weights depend on

(1) the external rating grade or an available inferred rating;

(2) the seniority of the position;

(3) the tranche maturity; and

(4) in the case of non-senior tranches, the tranche thickness.

42.4 Specifically, for exposures with long-term ratings, risk weights will be determined according to Table 2 and will be adjusted for tranche maturity (calculated according to CRE40.22 and CRE40.23), and tranche thickness for non-senior tranches according to CRE42.5.

ERBA risk weights for long-term ratings				Table 2
Rating	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity (M_T)		Tranche maturity (M_T)	
	1 year	5 years	1 year	5 years
AAA	15%	20%	15%	70%
AA+	15%	30%	15%	90%
AA	25%	40%	30%	120%
AA-	30%	45%	40%	140%
A+	40%	50%	60%	160%
A	50%	65%	80%	180%
A-	60%	70%	120%	210%
BBB+	75%	90%	170%	260%
BBB	90%	105%	220%	310%
BBB-	120%	140%	330%	420%
BB+	140%	160%	470%	580%
BB	160%	180%	620%	760%
BB-	200%	225%	750%	860%
B+	250%	280%	900%	950%
B	310%	340%	1050%	1050%
B-	380%	420%	1130%	1130%
CCC+/CCC/CCC-	460%	505%	1250%	1250%
Below CCC-	1250%	1250%	1250%	1250%

42.5 The risk weight assigned to a securitisation exposure when applying the SEC-ERBA is calculated as follows:

(1) To account for tranche maturity, banks shall use linear interpolation between the risk weights for one and five years.

(2) To account for tranche thickness, banks shall calculate the risk weight for non-senior tranches as follows, where T equals tranche thickness, and is measured a minus A, as defined, respectively, in CRE44.15 and CRE44.14:

$$Risk\ weight = (risk\ weight\ from\ table\ after\ adjusting\ for\ maturity) \times (1 - \min(T, 50\%))$$

42.6 In the case of market risk hedges such as currency or interest rate swaps, the risk weight will be inferred from a securitisation exposure that is pari passu to the swaps or, if such an exposure does not exist, from the next subordinated tranche.

42.7 The resulting risk weight is subject to a floor risk weight of 15%. In addition, the resulting risk weight should never be lower than the risk weight corresponding to a senior tranche of the same securitisation with the same rating and maturity.

Operational requirements for use of external credit assessments

42.8 The following operational criteria concerning the use of external credit assessments apply in the securitisation framework:

(1) To be eligible for risk-weighting purposes, the external credit assessment must take into account and reflect the entire amount of credit risk exposure the bank has with regard to all payments owed to it. For example, if a bank is owed both principal and interest, the assessment must fully take into account and reflect the credit risk associated with timely repayment of both principal and interest.

(2) The external credit assessments must be from an eligible external credit assessment institution (ECAI) as recognised by the bank's national supervisor in accordance with CRE21 with the following exception. In contrast with CRE21.2(3), an eligible credit assessment, procedures, methodologies, assumptions and the key elements underlying the assessments must be publicly available, on a non-selective basis and free of charge.[2] In other words, a rating must be published in an accessible form and included in the ECAI's transition matrix. Also, loss and cash flow analysis as well as sensitivity of ratings to changes in the underlying rating assumptions should be publicly available. Consequently, ratings that are made available only to the parties to a transaction do not satisfy this requirement.

(3) Eligible ECAIs must have a demonstrated expertise in assessing securitisations, which may be evidenced by strong market acceptance.

(4) Where two or more eligible ECAIs can be used and these assess the credit risk of the same securitisation exposure differently, CRE21.9 to CRE21.11 will apply.

(5) Where credit risk mitigation (CRM) is provided to specific underlying exposures or the entire pool by an eligible guarantor as defined in CRE22 and is reflected in the external credit assessment assigned to a securitisation exposure(s), the risk weight associated with that external credit assessment should be used. In order to avoid any double-counting, no additional capital recognition is permitted. If the CRM provider is not recognised as an eligible guarantor under CRE22, the covered securitisation exposures should be treated as unrated.

(6) In the situation where a credit risk mitigant solely protects a specific securitisation exposure within a given structure (eg asset-backed security tranche) and this protection is reflected in the external credit assessment, the bank must treat the exposure as if it is unrated and then apply the CRM treatment outlined in CRE22 or in the foundation internal ratings-based (IRB) approach of CRE30 to CRE36, to recognise the hedge.

(7) A bank is not permitted to use any external credit assessment for risk-weighting purposes where the assessment is at least partly based on unfunded support provided by the bank. For example, if a bank buys asset-backed commercial paper (ABCP) where it provides an unfunded securitisation exposure extended to the ABCP programme (eg liquidity facility or credit enhancement), and that exposure plays a role in determining the credit assessment on the ABCP, the bank must treat the ABCP as if it were not rated. The bank must continue to hold capital against the other securitisation exposures it provides (eg against the liquidity facility and/or credit enhancement).

Footnotes

2 *Where the eligible credit assessment is not publicly available free of charge, the ECAI should provide an adequate justification, within its own publicly available code of conduct, in accordance with the "comply or explain" nature of the International Organization of Securities Commissions' Code of Conduct Fundamentals for Credit Rating Agencies.*

Operational requirements for inferred ratings

42.9 In accordance with the hierarchy of approaches determined in CRE40.41 to CRE40.47, a bank must infer a rating for an unrated position and use the SEC-ERBA provided that the requirements set out in CRE42.10 are met. These requirements are intended to ensure that the unrated position is pari passu or senior in all respects to an externally-rated securitisation exposure termed the "reference securitisation exposure".

42.10 The following operational requirements must be satisfied to recognise inferred ratings:

(1) The reference securitisation exposure (eg asset-backed security) must rank pari passu or be subordinate in all respects to the unrated securitisation exposure. Credit enhancements, if any, must be taken into account when assessing the relative subordination of the unrated exposure and the reference securitisation exposure. For example, if the reference securitisation exposure benefits from any third-party guarantees or other credit enhancements that are not available to the unrated exposure, then the latter may not be assigned an inferred rating based on the reference securitisation exposure.

(2) The maturity of the reference securitisation exposure must be equal to or longer than that of the unrated exposure.

(3) On an ongoing basis, any inferred rating must be updated continuously to reflect any subordination of the unrated position or changes in the external rating of the reference securitisation exposure.

(4) The external rating of the reference securitisation exposure must satisfy the general requirements for recognition of external ratings as delineated in CRE42.8.

Alternative capital treatment for term STC securitisations and short-term STC securitisations meeting the STC criteria for capital purposes

42.11 Securitisation transactions that are assessed as simple, transparent and comparable (STC)-compliant for capital purposes as defined in CRE40.67 can be subject to capital requirements under the securitisation framework, taking into account that, when the SEC-ERBA is used, CRE42.12, CRE42.13 and CRE42.14 are applicable instead of CRE42.2, CRE42.4 and CRE42.7 respectively.

42.12 For exposures with short-term ratings, or when an inferred rating based on a short-term rating is available, the following risk weights will apply:

ERBA STC risk weights for short-term ratings — Table 3

External credit assessment	A-1/P-1	A-2/P-2	A-3/P-3	All other ratings
Risk weight	10%	30%	60%	1250%

42.13 For exposures with long-term ratings, risk weights will be determined according to Table 4 and will be adjusted for tranche maturity (calculated according to CRE40.22 and CRE40.23), and tranche thickness for non-senior tranches according to CRE42.5 and CRE42.6.

ERBA STC risk weights for long-term ratings — Table 4

Rating	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity (M_T)		Tranche maturity (M_T)	
	1 year	5 years	1 year	5 years
AAA	10%	10%	15%	40%
AA+	10%	15%	15%	55%
AA	15%	20%	15%	70%
AA-	15%	25%	25%	80%
A+	20%	30%	35%	95%
A	30%	40%	60%	135%
A-	35%	40%	95%	170%
BBB+	45%	55%	150%	225%
BBB	55%	65%	180%	255%
BBB-	70%	85%	270%	345%
BB+	120%	135%	405%	500%
BB	135%	155%	535%	655%
BB-	170%	195%	645%	740%
B+	225%	250%	810%	855%
B	280%	305%	945%	945%
B-	340%	380%	1015%	1015%
CCC+/CCC/CCC-	415%	455%	1250%	1250%
Below CCC-	1250%	1250%	1250%	1250%

42.14 The resulting risk weight is subject to a floor risk weight of 10% for senior tranches, and 15% for non-senior tranches.