SEC-SA P-Factor – Executive Summary

Background

P-factor and RW floors were introduced in the CRR to create a **non-neutrality effect in capital** vs underlying portfolio to **account for agency and modelling risks** specific to securitisation.

Agency Risk

- For on balance-sheet securitisations aiming at risk transfer where the originator retains the senior tranches, there is **no information asymmetry**
- These deals are also rarely rated so **no rating agency risk**

Modelling Risk

- Number of initiatives have **significantly reduced modelling risk** over last 10 years:
  - **EBA IRB Repair**: harmonisation of modelling practices (2013)
  - **TRIM**: deep review of banks' main internal models by Supervisors
  - **Model risk management frameworks and capital** attributed to model risk
  - **Forward-looking yearly stress tests**, to complement historical models
- P-factors and RW floors have not been amended to reflect these model risk mitigants and instead non-neutrality has actually increased in recent years

Calibration Approach (SEC-SA only)

The **excessive conservatism incorporated in the SEC-SA** has limited the ability for smaller, standardised banks to undertake significant risk transfer due to the necessity to place large, uneconomical tranches.

The following slides show analysis for proposed SEC-SA p-factor recalibration – recalibration normalises the outsized Basel IV Output Floor impact post-securitisation to **achieve the same capital impact as experienced on the pre-securitisation portfolio**.

For both non-STS and STS, using **half the current p-factor value** achieves this targeted impact (based on real world transactions).

Proposal

SEC-SA Non-STS: P-Factor = 0.5

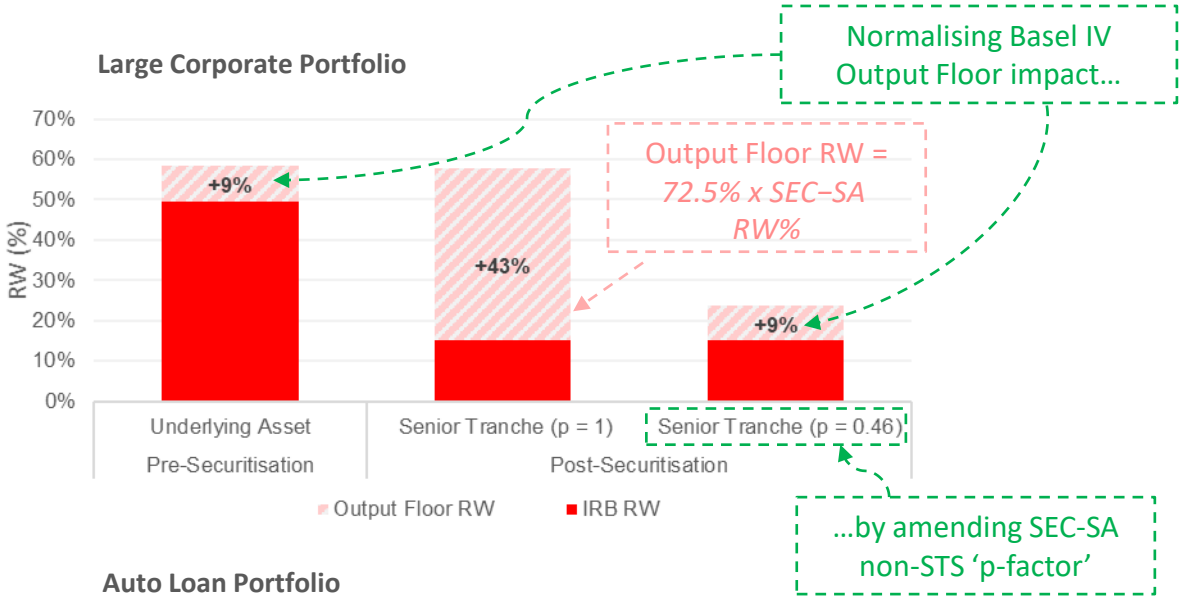
SEC-SA STS: P-Factor = 0.25

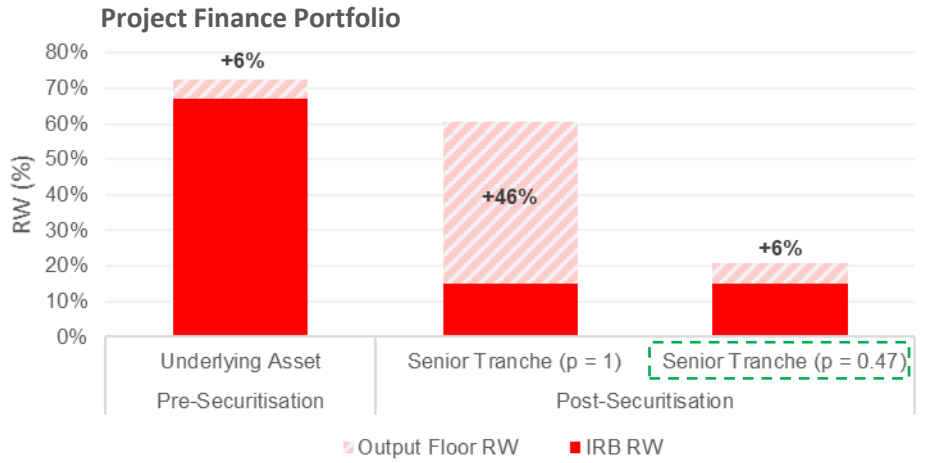
- Conservatism remains, such that Basel IV Output Floor is normalised to pre-securitisation impact, despite **only retaining senior credit risk**
- Conservatism of **non-neutrality still present at c.150% and 125%** of pre-securitisation capital for Non-STS and STS respectively
- **Enables smaller, standardised banks to utilise SRT** to manage portfolio risk and raise capital at efficient level
- **Aligned to Capital Markets Union High Level Forum recommendations** of June 2020

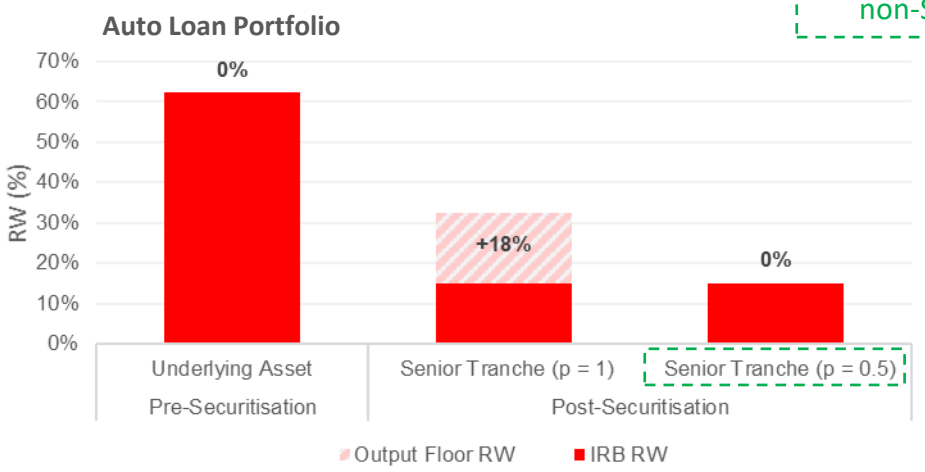
SEC-SA Non-STS

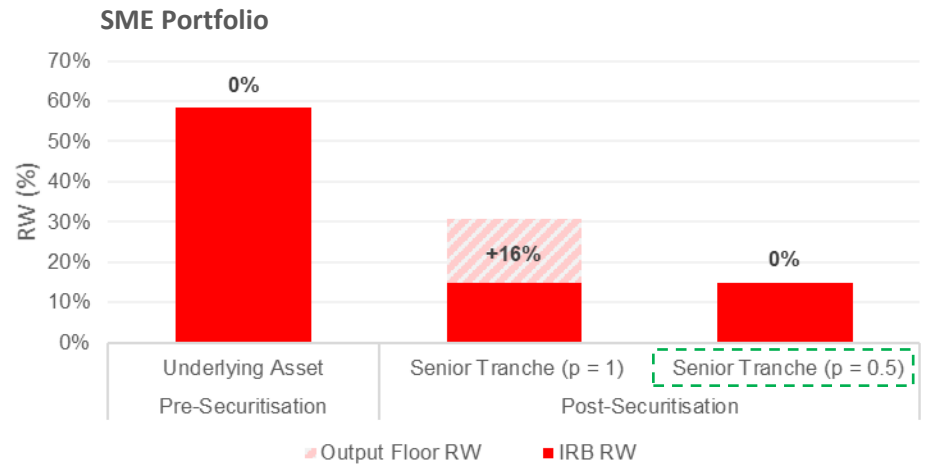
Proposal: p=0.50

Following real-world examples demonstrate the p-factor required to normalise impact on SEC-IRBA transactions; all examples return result around **p=0.5**, as proposed.







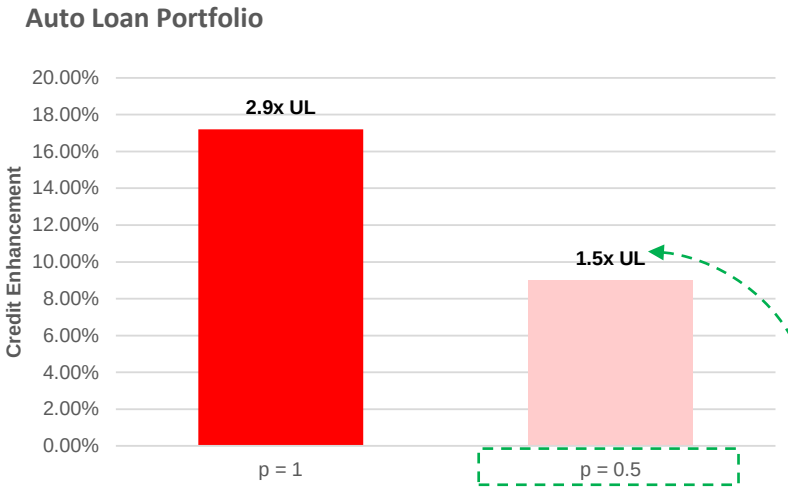


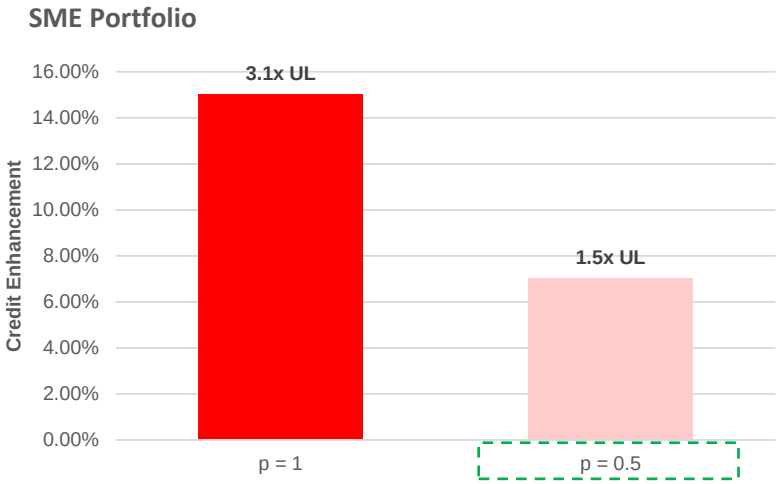
SEC-SA Non-STS

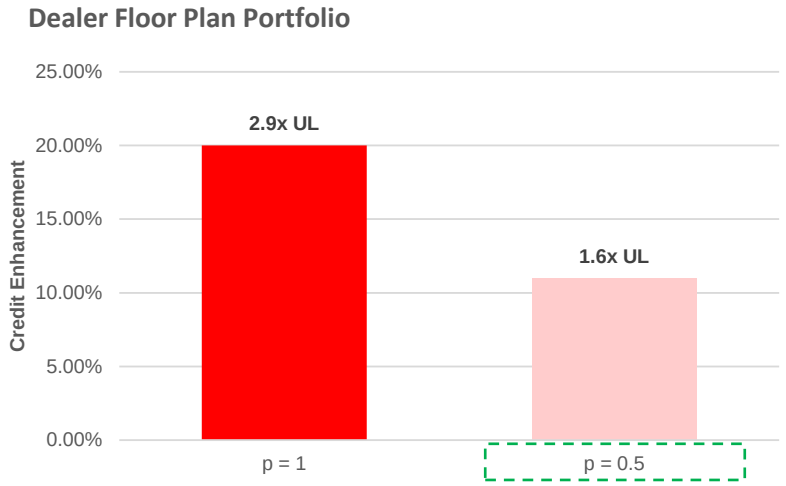
Proposal: p=0.50

Amending the SEC-SA p-factor to 0.50 for non-STS transactions will still result in a significant amount of conservatism within the RW formula, allowing for the principal of non-neutrality to remain.

Examples: Real-world *SEC-SA* transactions, amending placed tranche size to still hit 15% RW floor





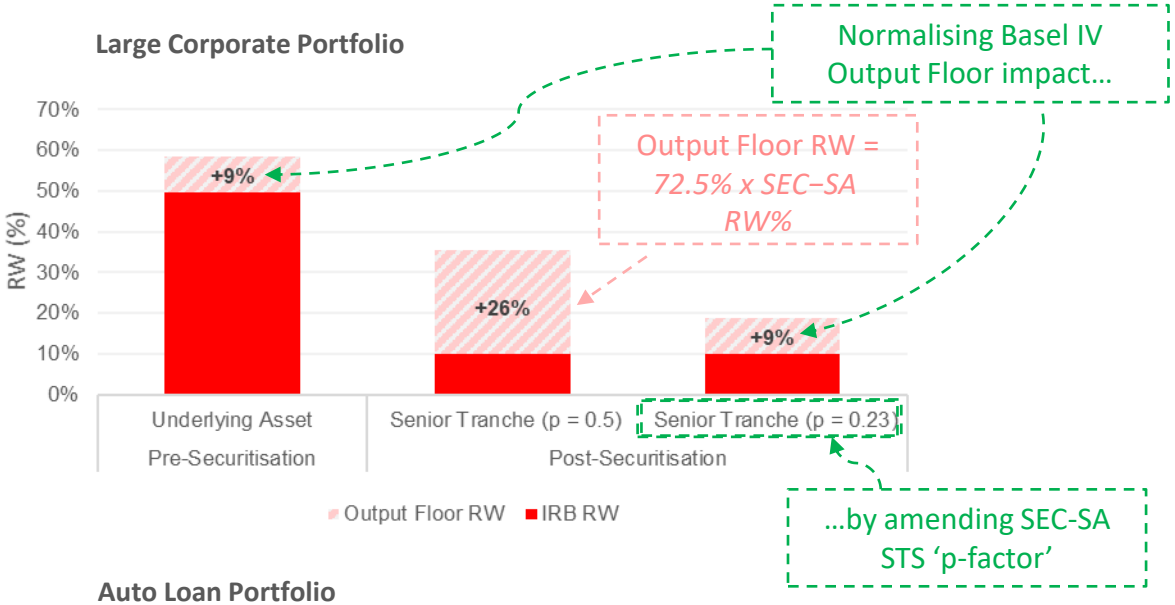


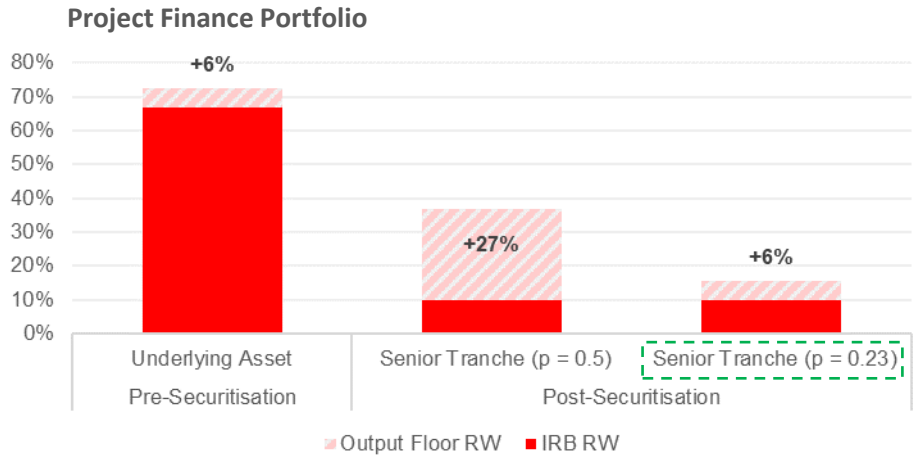
Significant credit enhancement to senior tranche remains to cover expected and unexpected losses

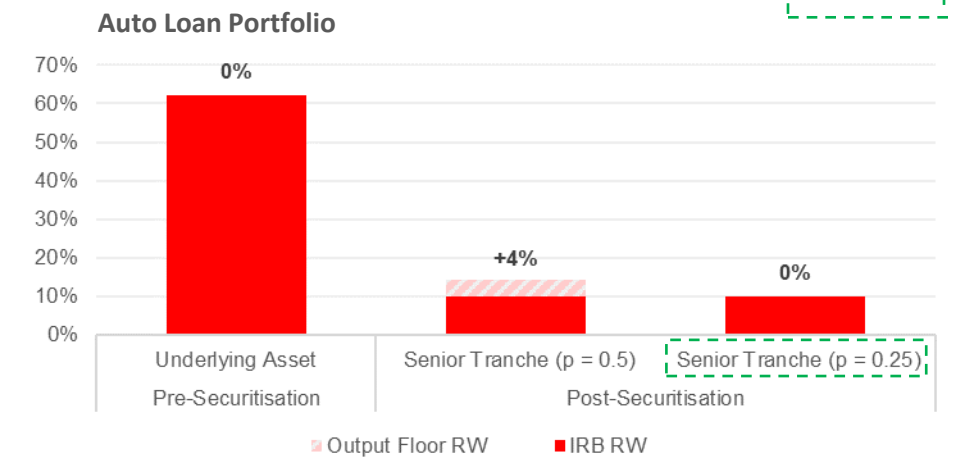
SEC-SA STS

Proposal: p=0.25

Following real-world examples[1] demonstrate the p-factor required to normalise impact on SEC-IRBA transactions; all examples return results around **p=0.25**, as proposed.







[1] Non-STS transactions, with estimated reductions in placed tranche size assuming STS. Due to recency of new STS synthetics framework, no actual real-world STS transactions to use.