

# Article

## BASEL COMMITTEE PROPOSES TOTAL RECAST OF REGULATORY CAPITAL FRAMEWORK FOR SECURITISATION



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Securitisation practitioners may be very inactive, but regulators are very very active. Exactly opposite of what was the scenario pre 2007 when practitioners were highly active.

Securitisation continues to see a spate of rule-making. Practitioners may yet not have become used to risk-retention rules, rating agency oversight, bar on proprietary trading, and so on. And in the meantime, the Basel Committee for Banking Supervision (BCBS) has proposed a total recast of regulatory capital framework for securitisation transactions. This is independent of Basel III, which anyways is slated to applied in phases starting this year. A Dec 2012 proposal to replace the current regulatory capital framework was [placed on the site of BCBS](#) for comments. The proposals are open to comments by 15<sup>th</sup> March 2013.

The genesis of the new regulatory framework is that the existing rules place too mechanistic reliance on ratings, and while doing so, put too low risk weight for top-rated securitisation tranches (under the RBA approach, the best rated transaction subject to conditions gets a 7% risk weight, which translates into 0.56% capital), and very high risk weights for lower-rated tranches.

Existing capital requirement for securitisations is based on either the Standardised Approach (SA) or the IRB approach. Under the IRB option, if there are external ratings, the approach is ratings-based approach (RBA), or a very complicated supervisory formula approach (SFA), or, in case of liquidity support to ABCP conduits, etc., the internal assessment approach (IAA).

The revised proposal puts up 2 alternatives, presumably to ease out the present complicated set of computations. Honestly, the revised set of computations is far more complex and far more risk weight computations than at present.

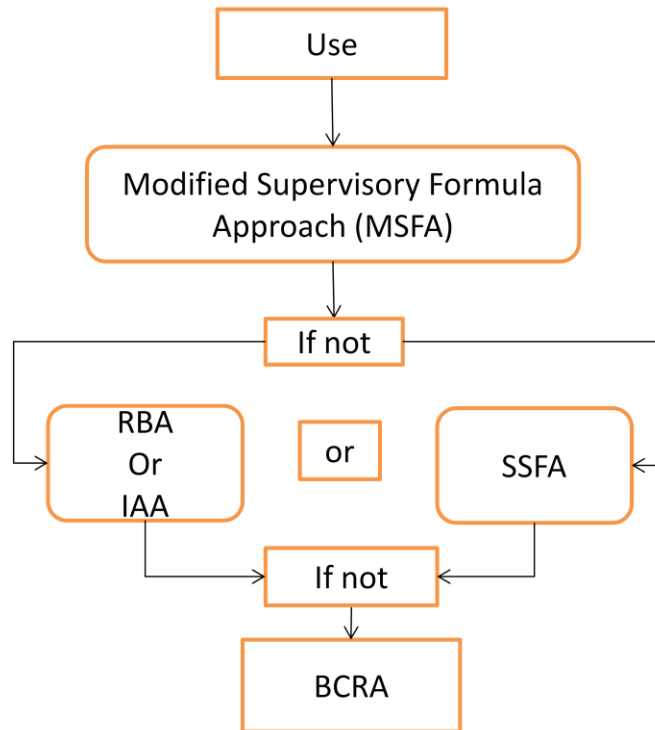
### **Alternative A:**

Under this alternative, the bank will need to compute capital applying a Modified Supervisory Formula (MSFA). This is applicable for all banks which have been entitled to use the IRB approach. The essential justification for forcing banks to use the MSFA approach is to reduce dependence on external ratings for capital computation. If the MFSA cannot be used, then, based on the choice of the jurisdiction, the bank may use RBA or a Simplified Supervisory Formula (SSFA). If neither of these two approaches could be used, the bank would use a Backstop Concentration Ration (BCRA), which, in essence, is the SA-risk-weighted capital required for the underlying pool.



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## Alternative 1



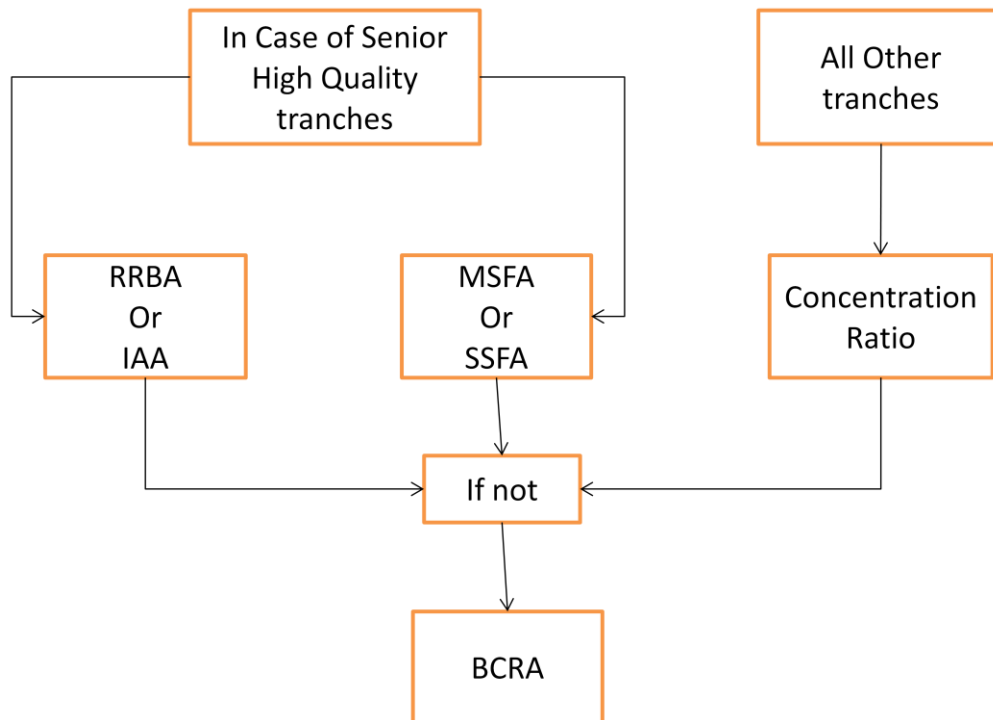
### Alternative B:

Under this alternative, the bank will distinguish between senior high quality exposures, and other exposures. A senior high quality exposure is one with a collateral of strong quality, and ratings corresponding to AAA to AA-. In such cases, at the top of the hierarchy would be revised RBA (RRBA), or MSFA. If the bank is unable to apply the MSFA, the bank will apply the SSFA.

In case of all other tranches, the bank will apply a concentration ratio based on the  $K_{IRB}$ . In case of either of these approaches not being applied, the backstop concentration ratio (BCRA) will still be applicable.



## Alternative 2



### Revised RBA table in Alternative I:

The table for risk weights under the revised RBA includes additional parameters in computation of risk weights, as opposed to the rating, seniority and granularity as under the existing RBA table. The combined result of each of these parameters is that the table of risk weights is a daunting matrix of 171 different risk weights (17 rows, 10 columns, plus 1 1250% risk weight applicable to below ccc- rating).

### Revised RBA table in Alternative II:

The table for risk weights under the revised RBA under Alternative II goes for ratings from AAA to AA- (as that is only where this approach applies). This one is a much simpler 5 X 5 matrix.



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### **Modified Supervisory Formula approach (MSFA):**

The MSFA computes capital charge through a regressive formula that takes into account the attachment and detachment point of the tranche, the maturity of the tranche, the asset value correlations, and loss given default of the underlying obligations. The computation needs a loan by loan IRB estimate, though a top-down approach will be permitted in case of acquired portfolios.

### **Simplified Supervisory Formula approach (SSFA):**

The SSFA is also a regressive formula, based on average SA capital charge for the underlying exposures, attachment and detachment points for the tranches, etc. A unique feature of this method is to introduce a risk sensitiveness to the capital charge by scaling up the capital charge based on the percentage of delinquent receivables (>90 days due) in the pool. The formula here involves a supervisory input called  $p$  will be calibrated based on quantitative impact study.

### **Concentration ratio (CR):**

The CR approach is simply the relationship between the  $K_{IRB}$  of the exposure (the precondition for application of the CR approach is that the bank is able to compute the  $K_{IRB}$  for the exposure), and the detachment point ( $D$ ). For example, if  $D$  is 4%, while  $K_{IRB}$  is 6%, the risk weight as per CR will be  $12.5 * 4 / 6\%$ . If the  $K_{IRB}$  is 4%, and  $D$  is also 4%, the securitisation exposure is like a first loss piece, and will attract 1250% risk weight.

### **Backstop concentration ratio (BCRA)**

The intuitive idea of the BCRA is the same as in case of CR. However, instead of  $K_{IRB}$ , the bank applies the  $K_{SA}$ , that is, the risk weights under the SA approach for the underlying exposures in the pool. The  $K_{SA}$  so computed is scaled by a factor which is 1 in case of senior exposures, and 2 in case of non-senior exposures.