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DIVISION OF BANKING
SUPERVISION AND REGULATION

BASEL COORDINATION COMMITTEE
(BCC) BULLETIN

BCC 15-1

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SUBJECT: Supervisory Guidance for Implementation of the Simplified Supervisory Formula Approach for Securitization Exposures under the Advanced Approaches Risk-Based Capital Rule

This guidance summarizes supervisory expectations about how banking organizations determine when the simplified supervisory formula approach (SSFA), rather than the supervisory formula approach (SFA), may be used to calculate risk-weighted assets for securitization exposures under the advanced approaches risk-based capital rule (rule).[1] Staff at the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Board) worked closely together to develop this guidance.

Background

Under the rule, for a securitization exposure that does not automatically require deduction from capital or a 1,250 percent risk weight, the risk-weighted asset amount must be computed using the SFA when the banking organization can reasonably calculate the SFA parameters on an ongoing basis.[2] Otherwise, the SSFA must be applied or the exposure generally receives a 1,250 percent risk weight.[3]

Relative to the SSFA, the SFA requires the following additional input parameters: the capital requirement against the underlying exposures (K_{IRB}), the effective number of exposures (N), and the exposure-weighted average loss given default (EWALGD). Typically, the K_{IRB} parameter is the most challenging to calculate on an ongoing basis.

Supervisors recognize that the acquisition and analysis of data needed to implement the SFA can sometimes be costly, especially when origination and servicing of the underlying securitized exposures are carried out by unrelated third parties. The OCC's and the Board's 2013 guidance addresses the flexibility afforded banking organizations when calculating K_{IRB} in the

[1] This guidance uses the term "banking organization" to refer to any OCC-supervised institution subject to the advanced approaches risk-based capital rule set forth at 12 CFR 3, subpart E, and to any Board-regulated institution that uses the advanced approaches risk-based capital rule set forth in 12 CFR 217, subpart E.

[2] See 12 CFR 3.143(a) (OCC) and 12 CFR 217.143(a) (Board).

[3] See 12 CFR 3.142(a)(4) (OCC) and 12 CFR 217.142(a)(4) (Board).

face of data limitations.[4] That guidance notes that a banking organization "must make a good faith effort to obtain data to support its risk quantification process." Furthermore, when data limitations introduce material uncertainty and less confidence in the accuracy of estimates, a banking organization may still employ the SFA, provided the banking organization can demonstrate that K_{IRB} is appropriately conservative.

The rule's preamble notes that "[t]he agencies expect banking organizations to use the SFA rather than the SSFA in all instances where data to calculate the SFA is available" and that "[a] banking organization should be able to explain and justify (for example, based on data availability) to its primary federal supervisor any instances in which the banking organization uses the SSFA rather than the SFA for its securitization exposures."[5] The guidance below summarizes supervisory expectations for determining when a banking organization may use the SSFA rather than the SFA in the face of data limitations. The determining factors are materiality of securitization exposures with respect to a given asset class and whether a banking organization is an investing or originating bank.

General Implementation Guidance

For securitizations in which a banking organization meets the rule's definition of an "originating [banking organization],"[6] the SFA generally should be used to calculate risk-weighted assets. An originating banking organization, by definition, must either directly or indirectly originate or securitize the underlying exposures or serve as the sponsor of the asset-backed commercial paper program. Such a banking organization is presumed to have a detailed understanding of the risk profile of the underlying exposures in order to properly execute its responsibilities. Given the flexibility discussed in relevant guidance (GAA 2013-01, BCC 2013-7), supervisors generally expect that an originating banking organization has access to data and risk measurement technologies needed to apply the SFA. In the limited circumstances when an originating banking organization instead applies the SSFA, supervisors expect the banking organization to provide detailed and robust justification for not applying the SFA.

For securitizations in which a banking organization meets the rule's definition of an "investing [banking organization],"[7] the banking organization may consider the materiality of its total securitization exposures to the underlying asset type when determining whether to apply the SFA in the face of data limitations. Relative to an originating banking organization, an investing banking organization may face significantly greater challenges and cost when attempting to acquire data to implement the SFA. It is reasonable to balance such factors against the potential for enhanced risk measurement under the SFA compared with the SSFA. Thus, when an investing banking organization has an immaterial aggregate exposure to securitizations backed

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[4] Refer to Guidance on Advanced Approaches (GAA) 2013-01, "Implementing the Supervisory Formula Approach for Securitization Exposures," October 28, 2013, (OCC); and Basel Coordination Committee (BCC) Bulletin 2013-7 "Implementing the Supervisory Formula Approach for Securitization Exposures," October 28, 2013, (Board).

[5] Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule; Final Rule, *Federal Register*, Volume 78, Number 198 page 62141.October 11, 2013.

[6] See 12 CFR 3.2 (OCC) and 12 CFR 217.2 (Board). For purposes of this guidance, servicing banks are considered "originating banking organizations."

[7] See 12 CFR 3.2 (OCC) and 12 CFR 217.2 (Board).

by a particular asset class (for example, credit-card backed securities), supervisors do not expect the banking organization to expend significant resources to implement the SFA. In such cases, use of the SSFA may be justified because of immateriality.

Supervisors expect that a banking organization assesses the materiality threshold of securitization exposures with respect to a given asset class based on a variety of factors. A banking organization's analysis of its determination of materiality should be commensurate with the complexity, risk profile, trend, and size of the aggregate securitization exposures in relation to regulatory capital of the banking organization. For example, a growing portfolio of securitization exposures (backed by a given asset class) that aggregates to 3 percent to 4 percent of tier 1 capital may be considered as "material." In another situation, securitization exposures in a run-off portfolio representing over 5 percent of tier 1 capital may be considered as "immaterial." The banking organization should determine materiality based on a careful and well-documented analysis and should be independently verified, as appropriate.[8]

For securitization exposures that, in the aggregate, are material with respect to a given type of underlying asset class, an investing banking organization is expected to make a good-faith effort to apply the SFA. In particular, a banking organization generally will be expected to apply the SFA when relevant data on the underlying exposures are reasonably obtainable internally or through third-party vendors. For example, supervisors have observed that data for applying the SFA to residential mortgage-backed securities typically are readily obtainable from internal or third-party sources. Similarly, with reasonable effort, several investing banking organizations also have successfully used the SFA for other types of asset-backed securities, such as instruments backed by credit card and auto loan receivables. A banking organization, as part of its analysis and documentation, will need to provide justification that it has made reasonable efforts to collect appropriate data for applying the SFA. Supervisors will review carefully instances when the banking organization's aggregate securitization exposure to an underlying asset class is material, but nevertheless the SSFA is applied to such positions.

[8] See BCC 2013-3, "Guidance for Independent Verification of a Bank's Advanced Approaches Systems," May 2, 2013.