

compliance with the infrastructure requirements and supervisory standards for approval to use the A-IRB approach for regulatory capital purposes. As noted, the Agencies will be developing and issuing specific implementation guidance describing the supervisory standards for wholesale, retail, equity and securitization exposures. The Agencies will issue the draft implementation guidance for each portfolio for public comment to ensure that there is an opportunity for banking organizations and others to provide feedback on the Agencies' expectations in regard to A-IRB systems.

The Agencies seek comment on the extent to which an appropriate balance has been struck between flexibility and comparability for the A-IRB requirements. If this balance is not appropriate, what are the specific areas of imbalance, and what is the potential impact of the identified imbalance? Are there alternatives that would provide greater flexibility, while meeting the overall objectives of producing accurate and consistent ratings?

The Agencies also seek comment on the supervisory standards contained in the draft guidance on internal ratings-based systems for corporate exposures. Do the standards cover all of the key elements of an A-IRB framework? Are there specific practices that appear to meet the objectives of accurate and consistent ratings but that would be ruled out by the supervisory standards related to controls and oversight? Are there particular elements from the corporate guidance that should be modified or reconsidered as the Agencies draft guidance for other types of credit?

In addition, the Agencies seek comment on the extent to which these proposed requirements are consistent with the ongoing improvements banking organizations are making in credit-risk management processes.

IV. Securitization

A. General Framework

This section describes the calculation of A-IRB capital requirements for securitization exposures. A securitization exposure is any on- or off-balance-sheet position created by aggregating and then tranching the risks of a pool of assets, commitments, or other instruments (underlying exposures) into multiple financial interests where, typically, the pooled risks are not shared *pro rata*. The pool may include one or more underlying exposures. Examples include all exposures arising from traditional and synthetic securitizations, as well as partial guarantee arrangements where credit losses are not divided proportionately among the parties (often referred to as *tranching*). Asset- and mortgage-backed securities (including those privately issued and

those issued by GSEs such as Fannie Mae and Freddie Mac), credit enhancements, liquidity facilities, and credit derivatives that have the characteristics noted above would be considered securitization exposures.

With ongoing advances in financial engineering, the Agencies recognize that securitization exposures having similar risks can take different legal forms. For this reason, both the designation of positions as securitization exposures and the calculation of A-IRB capital requirements for securitization exposures would be guided by the economic substance of a given transaction, rather than by its legal form.

Operational Criteria

Banking organizations would have to satisfy certain operational criteria to be eligible to use the A-IRB approach to securitization exposures. Moreover, all banking organizations that use the A-IRB approach for the underlying exposures that have been securitized would have to apply the A-IRB treatment for securitization exposures. Minimum operational criteria would apply to traditional and synthetic securitizations. The Agencies propose to establish supervisory criteria for determining when, for risk-based capital purposes, a banking organization may treat exposures that it has originated directly or indirectly as having been securitized and, hence, not subject to the same capital charge as if the banking organization continued to hold the assets. The Agencies anticipate these supervisory criteria will be substantially equivalent to the criteria contained in the New Accord (paragraphs 516–520). Broadly, these criteria are intended to ensure that securitization transactions transfer significant credit risk to third parties and, in the case of traditional securitizations, that each transaction qualifies as a true sale under applicable accounting standards.

The supervisory criteria also would describe the types of clean-up calls that may be incorporated within transactions qualifying for the A-IRB securitization treatment.²⁸ Specifically, any clean-up call would have to meet the following conditions: (a) Its exercise is at the discretion of the originating banking organization; (b) it does not serve as a credit enhancement; and (c) it is only exercisable when 10 percent or less of the original underlying portfolio or reference portfolio value remains. If a clean-up call does not meet all of these

²⁸ In general terms, a clean-up call is an option that permits an originating banking organization to call the securitization exposures (for example, asset- or mortgage-backed securities) before all of the underlying exposures have been repaid.

criteria, the originating banking organization would have to treat the underlying exposures as if they had not been securitized.

The Agencies seek comment on the proposed operational requirements for securitizations. Are the proposed criteria for risk transference and clean-up calls consistent with existing market practices?

Differences Between General A-IRB Approach and the A-IRB Approach for Securitization Exposures

In contrast to the proposed A-IRB framework for traditional loans and commitments, the A-IRB securitization framework does not rely on a banking organization's own internal assessments of the PD and LGD of a securitization exposure. For securitization exposures backed by pools of multiple assets, such assessments require implicit or explicit estimates of correlations among the losses on those assets. Such correlations are extremely difficult to estimate and validate in an objective manner and on a going-forward basis. For this reason, the A-IRB framework generally would not permit a banking organization to use its internal risk assessments of PD or LGD when such assessments depend, implicitly or explicitly, on estimates of correlation effects. The A-IRB treatment of securitization exposures would rely principally on two sources of information, when available: (i) An assessment of the securitization exposure's credit risk made by an external rating agency; and (ii) the A-IRB capital charge that would have been assessed against the underlying exposures had the exposures not been securitized (the pool's A-IRB capital charge), along with other information about the transaction.

B. Determining Capital Requirements

General Considerations

Because the information available to a banking organization about a securitization exposure often reflects the organization's role in a securitization transaction, the Agencies are proposing that the method of calculating the A-IRB capital requirement for a securitization exposure may depend on whether a banking organization is an originator or a third-party investor in the securitization transaction. In general, a banking organization would be considered an originator of a securitization if the organization directly or indirectly originated the underlying exposures or serves as the sponsor of an asset-backed commercial paper (ABCP) conduit or similar