

where an A-IRB treatment for the underlying exposures exists, the institution would use the Ratings-Based Approach (RBA) described below if the securitization exposure is externally rated or if an inferred rating is available (as defined in the RBA discussion below). When neither an external rating nor an inferred rating is available, an investing banking organization would compute the A-IRB capital charge for the exposure using the methodology described below for originating institutions (subject to supervisory review and approval). Otherwise, the securitization exposure would be deducted 50 percent from Tier 1 capital and 50 percent from Tier 2 capital. The Agencies anticipate that investing banking organizations would apply the RBA in the vast majority of situations.

Originators

This section presumes that an A-IRB approach exists for the underlying exposures. If no A-IRB treatment exists for the underlying exposures, then an originating banking organization (originator) would use the Alternative RBA discussed below.

In contrast to third-party investors, banking organizations that originate securitizations are presumed to have much greater access to information about the current credit quality of the underlying exposures. In general, when an originator retains a securitization exposure, the A-IRB securitization framework would require the institution to calculate, on an ongoing basis, the underlying exposure pool's A-IRB capital requirement had the underlying exposures not been securitized (the pool's A-IRB capital charge), which would be based on the notional dollar amount of underlying exposures (the size of the pool). The pool's A-IRB capital charge would be calculated using the top-down or bottom-up method applicable to the type(s) of underlying exposure(s).³² As noted above, the pool's A-IRB capital charge divided by the size of the pool is denoted KIRB.

An originator also would be expected to know: (a) Its retained securitization exposure's nominal size relative to the size of the pool (the exposure's "thickness," denoted T); and (b) the notional amount of all more junior securitization exposures relative to the size of the pool (the exposure's "credit enhancement level," denoted L). The

retained securitization exposure's A-IRB capital requirement depends on the relationship between KIRB, T, and L. If an originator cannot determine KIRB, any retained securitization exposure would be deducted from capital. For eligible liquidity facilities (defined below in the Look Through Approach) provided to ABCP programs where a banking organization lacks the information necessary to calculate KIRB, the Look-Through Approach described below would be applied on a temporary basis and subject to supervisory approval.

Positions Below KIRB

An originating banking organization would deduct from capital any retained securitization exposure (or part thereof) that absorbs losses at or below the level of KIRB (that is, an exposure for which $L+T \leq \text{KIRB}$).³³ This means that an originating banking organization would be given no risk-based capital relief unless it sheds at least some exposures below KIRB. Deduction from capital would be required regardless of the securitization exposure's external rating. This deduction treatment is in contrast to the A-IRB capital treatment for investors, who would be able to look to the external (or inferred) rating of a securitization exposure regardless of whether the exposure was below KIRB.

While this disparate treatment of originators and investors may be viewed as inconsistent with the principle of equal capital for equal risk, the Agencies believe it is appropriate in order to provide incentives for originating banks to shed highly subordinated securitization exposures. Such exposures contain the greatest credit risks. Moreover, these risks are difficult to evaluate, and risk quantifications tend to be highly sensitive to modeling assumptions that are difficult to validate objectively. The proposal to prevent an originator from using the RBA for securitization exposures below KIRB reflects, in part, a concern by the Agencies that the market discipline underpinning an external credit rating may be less effective when the rating applies to a retained, non-traded securitization exposure and is sought by an originator primarily for regulatory capital purposes.

The Agencies note that the specific securitization exposures retained by an originator that are subject to deduction treatment could change over time in response to variations in the credit

quality of the underlying exposures. For example, if the pool's A-IRB capital charge were to increase after the inception of a securitization, additional portions of securitization exposures held by an originator may fall below KIRB and, thus, become subject to deduction. Therefore, when an originator retains a first-loss securitization exposure well in excess of KIRB, the originator's A-IRB capital requirement on the exposure could climb rapidly in the event of any marked deterioration of the underlying exposures. In general, an originator could minimize variability in future capital charges by minimizing the size of any retained first-loss securitization exposures.

Positions Above KIRB

When an originating banking organization retains a securitization exposure, or part thereof, that absorbs losses above the KIRB amount (that is, an exposure for which $L + T > \text{KIRB}$) and the banking organization has not already met the maximum capital requirement for securitization exposures described previously, the A-IRB capital requirement for the exposure would be calculated as follows. For securitization exposures having an external or inferred rating, the organization would calculate its A-IRB capital requirement using the RBA. However, if neither an external rating nor an inferred rating is available, an originator would be able to use the SFA, subject to supervisory review and approval. Otherwise, the organization would deduct the securitization exposure from total capital.

The Agencies seek comment on the proposed treatment of securitization exposures held by originators. In particular, the Agencies seek comment on whether originating banking organizations should be permitted to calculate A-IRB capital charges for securitizations exposures below the KIRB threshold based on an external or inferred rating, when available.

The Agencies seek comment on whether deduction should be required for all non-rated positions above KIRB. What are the advantages and disadvantages of the SFA approach versus the deduction approach?

Capital Calculation Approaches

The Ratings-Based Approach (RBA)

The RBA builds upon the widespread acceptance of external ratings by third-party investors as objective assessments of a securitization exposure's stand-alone credit risk. Certain minimum requirements would have to be satisfied in order for a banking organization to rely on an external credit rating for determining its A-IRB capital charge for a securitization exposure. To be

³² For the purpose of determining the A-IRB capital requirement for a securitization exposure, the top-down method could be used regardless of the maturity of the underlying exposures, provided the other eligibility criteria for employing the top-down approach are satisfied.

³³ If an originator holds a securitization exposure that straddles KIRB, the exposure must be decomposed into two separate positions—one that is above KIRB and another that is at or below KIRB.