

TABLE 2.—ABS RISK WEIGHTS BASED ON SHORT-TERM EXTERNAL CREDIT ASSESSMENTS

External rating (illustrative)	Thick tranches backed by highly granular pools	Base case	Tranches backed by non-granular pools
A-1/P-1	7%	12%	20%
A-2/P-2	N/A	20%	35%
A-3/P-3	N/A	75%	75%
All other ratings	N/A	Deduction	Deduction

The Agencies seek comment on the proposed treatment of securitization exposures under the RBA. For rated securitization exposures, is it appropriate to differentiate risk weights based on tranche thickness and pool granularity?

For non-retail securitizations, will investors generally have sufficient information to calculate the effective number of underlying exposures (N).

What are views on the thresholds, based on N and Q, for determining when the different risk weights apply in the RBA?

Are there concerns regarding the reliability of external ratings and their use in determining regulatory capital? How might the Agencies address any such potential concerns?

Unlike the A-IRB framework for wholesale exposures, there is no maturity adjustment within the proposed RBA. Is this reasonable in light of the criteria to assign external ratings?

The Supervisory Formula Approach (SFA)

As noted above, when an explicit A-IRB approach exists for the underlying exposures, originating and investing banking organizations would be able to apply the SFA to non-rated exposures above the KIRB threshold, subject to supervisory approval and review. The Agencies anticipate that, in addition to its application to liquidity facilities and to other traditional and synthetic securitization exposures, the SFA would be used when calculating A-IRB capital requirements for tranching guarantees (for example, a loan for which a guarantor assumes a first-loss position that is less than the full amount of the loan).

Under the SFA, the A-IRB capital charge for a securitization tranche would depend on six institution-supplied inputs:³⁸ the notional amount

of underlying exposures that have been securitized (E), the A-IRB capital charge had the underlying exposures not been securitized (KIRB); the tranche's credit enhancement level (L); the tranche's thickness (T); the pool's effective number of exposures (N); and the pool's exposure-weighted average loss-given-default (LGD). In general, the estimates of N and LGD would be developed as a by-product of the process used to determine KIRB.

The SFA capital charge for a given securitization tranche would be calculated as the notional amount of underlying exposures that have been securitized (E), multiplied by the greater of: (i) $0.0056 * T$ or (ii) the following expression:³⁹

$$K[L + T] - K[L] + \{(0.05 * d * KIRB * e^{-20(L - KIRB)/KIRB}) * (1 - e^{-20T/KIRB})\},$$

where,⁴⁰

$$h = (1 - KIRB / LGD)^N$$

$$c = KIRB / (1 - h)$$

$$v = \frac{(LGD - KIRB) KIRB + 0.25 (1 - LGD) KIRB}{N}$$

$$f = \left(\frac{v + KIRB^2}{1 - h} - c^2 \right) + \frac{(1 - KIRB) KIRB - v}{(1 - h) * 1000}$$

$$g = \frac{(1 - c) c}{f} - 1$$

$$a = g * c$$

$$b = g * (1 - c)$$

$$d = 1 - (1 - h) * (1 - \text{Beta}[KIRB; a, b])$$

$$K[x] = (1 - h) * (x * (1 - \text{Beta}[x; a, b]) + c * \text{Beta}[x; a + 1, b]).$$

Although visually daunting, the above supervisory formula is easily programmable within standard spreadsheet packages, and its various

components have intuitive interpretations.

Part (i), noted above, of the SFA effectively imposes a 56 basis point minimum or floor A-IRB capital charge

per dollar of tranche exposure. While acknowledging that such a floor is not risk-sensitive, the Agencies believe that some minimum prudential capital charge is nevertheless appropriate. The

³⁸ When the banking organization holds only a proportional interest in the tranche, that position's A-IRB capital charge equals the prorated share of the capital charge for the entire tranche.

³⁹ The SFA applies only to exposures above KIRB. When a securitization tranche straddles KIRB, for the purpose of applying the SFA the tranche should be decomposed into a position at or below KIRB and another above KIRB. The latter would be the position to which the SFA is actually applied.

⁴⁰ In these expressions, Beta[X; a, b] refers to the cumulative beta distribution with parameters a and b evaluated at X. The cumulative beta distribution function is available in Excel as the function BETADIST.