

## **First draft (Third batch – Asset Securitization)**

### **CAPITAL RULES**

#### **CONTENTS**

Sections

#### **PART 1**

##### **PRELIMINARY**

1. Commencement
2. Interpretation

#### **PART 2**

##### **APPLICATION OF THESE RULES**

3. Calculation of credit risk for securitization exposures
4. Use of RBM or SFM to calculate credit risk for securitization exposures under IRBS

## **PART 7**

### **SECURITIZATION**

#### ***Division 1 - General***

5. Treatment to be accorded securitization transaction by originating institution

[5A. Provision not used.]

6. Action that may be taken by Monetary Authority if originating institution provides implicit support

#### ***Division 2 – Calculation of regulatory capital for securitization exposures***

7. Calculation of risk-weighted amount

#### ***Division 3 – External credit assessments***

8. Use of external credit assessments for determination of risk-weights

9. Provisions applicable to ECAI ratings in addition to those applicable under [*Part 4*]

#### ***Division 4 – Deductions from capital base***

10. Deductions from capital base

#### ***Division 5 – Maximum capital requirement for originating institution***

11. General

***Division 5A – Risk-weighting requirements under STS***

- 12. Determination of risk-weights under STS
- 12A. Exceptions to deduction for unrated securitization exposures
- 13. Most senior tranche in securitization transaction
- 14. Securitization positions that are in second loss tranche or better in ABCP programmes

***Division 6 – Risk-weighting requirements under RBM***

- 15. Determination of risk-weights under RBM
- 16. Use of inferred ratings

***Division 7 – Risk-weighting requirements under SFM***

- [17A.] Application] – not used
- 17. Use of supervisory formula
- 18. Credit enhancement level of tranche ( $L$ )
- 19. Thickness of tranche ( $T$ )
- 20. Effective number of underlying exposures ( $N$ )
- 21. Exposure-weighted average  $LGD$
- 22. Simplified method for calculating  $N$  and  $LGD$

***Division 8 – Treatment of liquidity /servicer cash advance facilities***

- 23. Eligible liquidity facilities

- 24. Liquidity facilities under STS
- 25. Liquidity facilities under IRBS
- 26. Servicer cash advance facilities
- 27. Overlapping facilities

***Division 9 – Treatment of securitization exposures with early amortization provision***

- 28. Additional capital requirements for originating institutions
- 29. Exemption from early amortization treatment
- 30. Maximum regulatory capital for investors' interest
- 31. Investors' interest
- 32. Mechanics of calculating regulatory capital for investors' interest
- 32A. Meaning of controlled early amortization provision, etc.
- 33. CCFs for controlled early amortization provision
- 34. CCFs for non-controlled early amortization provision

***Division 9A – Treatment of interest rate and exchange rate contracts***

- 34A. Interest rate and exchange rate contracts

***Division 10 – Treatment of underlying exposures of originating institutions in  
synthetic securitizations***

- 35. General
- 36. Calculation of risk-weighted amount
- 37. Treatment of maturity mismatches

***Division 11 – Recognition of credit risk mitigation for securitization exposures***

- 38. General
- 39. [Provision not used]
- 39A. Recognized credit risk mitigation under STS
- 40. Recognized credit risk mitigation under RBM
- 41. Recognized credit risk mitigation under SFM – full protection
- 42. Recognized credit risk mitigation under SFM – partial protection

*SCHEDULE 1* Requirements applicable to or in relation to originating institution in traditional securitization before *section 5(1)(a)* of these Rules may be used

*SCHEDULE 2* Requirements applicable to or in relation to originating institution in synthetic securitization before *section 5(1)(b)* of these Rules may be used

*SCHEDULE 3* Requirements applicable for securitization transactions that include clean-up calls

*SCHEDULE 4* Mapping of ECAI issue specific ratings into credit quality grades/risk-weights applicable under STS

<i>SCHEDULE 5</i>	[Schedule not used]
<i>SCHEDULE 6</i>	[Schedule not used]
<i>SCHEDULE 7</i>	Mapping of ECAI issue specific ratings into credit quality grades/risk-weights applicable under RBM
<i>SCHEDULE 8</i>	[Schedule not used]
<i>SCHEDULE 9</i>	[Schedule not used]
<i>SCHEDULE 10</i>	CCFs for securitizations subject to controlled early amortization provision
<i>SCHEDULE 11</i>	CCFs for securitizations subject to non-controlled early amortization provision

## **CAPITAL RULES**

(Made by the Monetary Authority under section 98A of the Banking Ordinance (Cap. 155)

as amended by the Banking (Amendment) Ordinance 2005)

### **PART 1**

#### **Preliminary**

##### **1. Commencement**

These Rules shall come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

## 2. Interpretation

In these Rules, unless the context otherwise requires –

“ABCP programme” ( ) means an asset-backed commercial paper programme;

“asset-backed commercial paper programme” ( ) means a programme under which a bankruptcy-remote SPE in a securitization transaction issues debt securities –

- (a) with an original maturity of not more than one year; and
- (b) the payments in respect of which are secured by a pool of underlying exposures acquired from third parties and held by, or to the order of, that SPE;

“bankruptcy-remote” ( ), in relation to an SPE in a securitization transaction, means that the assets of the SPE will not be available to the creditors of the originator in the transaction in the event that the originator becomes insolvent;

“basic approach” ( ), in relation to the calculation of an authorized institution's credit risk, means the method of calculating that risk for non-securitization exposures set out in *Part 4*;

“BSA” ( ) means the basic approach;

“capital charge” ( ), in relation to an authorized institution's securitization exposures, means the amount of regulatory capital that the institution is required to hold to cover potential losses arising from the exposures;

“CCF” ( ) means credit conversion factor;



“clean-up call” ( ) -

- (a) in relation to a traditional securitization, means an option that permits the originator in the securitization transaction to repurchase the outstanding securitization issues of the securitization transaction once the amount of the outstanding securitization issues, or of the underlying exposures that have not been paid, has fallen below a level specified in the securitization documentation;
- (b) in relation to a synthetic securitization, means an option that permits the person providing credit protection under the securitization documentation to extinguish the credit protection once the amount of the reference pool of underlying exposures has fallen below a level specified in the securitization documentation;

“committed” ( ), in relation to a credit line (howsoever described), means the line is not uncommitted;

“credit conversion factor” ( ), in relation to an off-balance sheet exposure of an authorized institution, means a percentage by which the principal amount of the exposure is multiplied in order to obtain the credit equivalent amount of the exposure;

“credit enhancement” ( ), in relation to a securitization exposure under a securitization transaction, means a contractual arrangement whereby a person –

- (a) retains or assumes the credit risk in respect of the securitization exposure; and
- (b) provides, in substance, some degree of credit protection to one or more than one other party to the securitization transaction;

“credit-enhancing interest-only strip” ( ), in relation to a securitization transaction, means an on-balance sheet asset –

- (a) recorded by the originator in the securitization transaction as representing the expected future excess spread to be derived from the underlying exposures; and
- (b) that is subordinated to claims from other parties to the securitization transaction in terms of the priority of repayment;

“credit-enhancing I/O” ( ) means a credit-enhancing interest-only strip;

“credit equivalent amount” ( ), in relation to the calculation of investors' interest under the STS, means the principal amount of the undrawn balances to which investors are exposed, after the deduction of specific provisions applicable to those balances, multiplied by the applicable CCF specified in *Schedule 10* or *11*, as the case requires;

“credit protection” ( ), in relation to a credit exposure of an authorized institution, means the protection afforded the exposure by recognized credit risk mitigation;

“credit protection provider” ( ), in relation to credit protection, means the provider of the collateral or guarantee, or the protection seller under the credit derivative contract, constituting the credit protection;

“dilution risk” ( ), in relation to a receivable purchased by an authorized institution, means the possibility that the amount of the receivable is reduced through cash or non-cash credits to the receivable's obligor;

“drawn balances” ( ), in relation to the calculation of investors' interest, means the amounts of revolving credit lines that have been drawn by the obligors of the credit lines, where -

- (a) the credit lines have been sold into a securitization transaction; and
- (b) the investors remain, in whole or in part, exposed to future drawings by the obligors under the credit lines available to the obligors;

“EAD” ( ) means exposure at default;

“early amortization period” ( ), in relation to a securitization transaction of which the underlying exposures are revolving in nature, means the period of time within which the originator in the securitization transaction is obliged to fulfil the originator's obligations under an early amortization provision in the securitization documentation once the early amortization provision has been triggered;

“early amortization provision” ( ), in relation to a securitization transaction of which the underlying exposures are revolving in nature, means a mechanism which, once triggered, allows investors in the securitization

transaction to be paid out prior to the originally stated maturity of the securitization issues;

“ECAI” ( ) means external credit assessment institution;

“ECAI issue specific rating” ( ), in relation to a securitization exposure, means a current short-term or long-term credit assessment rating assigned to the exposure by an ECAI;

“EL” ( ) means expected loss;

“excess spread” ( ), in relation to a securitization transaction, means future interest and other income derived by the SPE in the securitization transaction from the underlying exposures of the securitization transaction in excess of the transaction costs specified in the securitization documentation;

“expected loss” ( ), in relation to an exposure of an authorized institution, means the expected loss of the institution on the exposure arising from –

- (a) the potential default of the obligor in respect of the exposure; or
- (b) the dilution risk relative to the EAD over one year;

“exposure at default” ( ), in relation to an exposure of an authorized institution, means the expected amount of the exposure –

- (a) upon the default of the obligor in respect of the exposure; and
- (b) measured without deduction of specific provisions and partial write-offs (being, in the case of an off-balance sheet exposure, the credit equivalent amount without such deduction);

“external credit assessment institution” ( ) means –

- (a) [Standard and Poor's Corporation;]
- (b) [Moody's Investors Services,  
Inc.; or]
- (c) [Fitch Ratings Ltd.;

“first loss tranche” ( ), in relation to a securitization transaction, means a securitization position that is retained by the originator for providing the first level of financial support to the SPE in the securitization transaction (whether by providing cover against losses incurred by the SPE or by selling assets to the SPE for below their book value or otherwise), under which the support bears, in effect, the risk associated with the underlying exposures held by, or to the order of, the SPE up to a specified or ascertainable level;

“funded credit protection” ( ), in relation to a credit exposure of an authorized institution, means a technique of credit risk mitigation –

- (a) whereby the reduction in credit risk of the exposure is derived from the institution's right, in the event of the default of an obligor in respect of the exposure or on the occurrence of other specified credit events relating to the obligor, to liquidate, to receive the transfer of, to appropriate or to retain certain assets or amounts; and
- (b) that may involve, for the purposes of *paragraph (a)*, the institution holding collateral against the exposure or issuing a credit-linked note to transfer the credit risk of the exposure to the purchaser of the note;

“gain-on-sale” ( ), in relation to a securitization transaction, means any increase in the core capital of the originating institution resulting from the sale of underlying exposures in the securitization transaction;

“implicit support” ( ), in relation to a securitization transaction, means any direct or indirect support that the originating institution provides (or has provided) to investors in the securitization transaction –

- (a) in excess of its predetermined contractual obligations; and
- (b) with a view to reducing potential or actual losses that the investors may suffer;

“inferred rating” ( ), in relation to a securitization exposure –

- (a) of an authorized institution which uses the RBM; and
- (b) which does not have an ECAI issue specific rating,

means a current short-term or long-term credit assessment rating attributed to the exposure by the institution pursuant to *section 16*;

“internal ratings-based approach” ( ), in relation to the calculation of an authorized institution's credit risk for non-securitization exposures, means the method of calculating that risk set out in *Division [..] of Part 4*;

“internal ratings-based securitization approach” ( ), in relation to the calculation of an authorized institution's credit risk for securitization exposures, means the method of calculating that risk set out in *Division [ ] of Part 7*;

“investing institution” ( ) means an investor which is an authorized institution;

“investment grade” ( ) –

- (a) in relation to the use by an authorized institution of the STS to calculate its credit risk for securitization exposures, means a credit quality grade of 3 or better for long-term or short-term ECAI issue specific ratings;
- (b) in relation to the use by an authorized institution of the IRBS to calculate its credit risk for securitization exposures, means a credit quality grade of –
  - (i) 8 or better for long-term ECAI issue specific ratings; and
  - (ii) 3 or better for short-term ECAI issue specific ratings;

“investor” ( ), in relation to a securitization transaction, means any person, other than the originator, who assumes securitization exposures by -

- (a) purchasing securitization issues;
- (b) providing credit protection to other parties to the securitization transaction; or
- (c) providing liquidity facilities in respect of the transaction;

“investors' interest” ( ), in relation to a securitization transaction of which the underlying exposures are revolving in nature and which has an early amortization provision, means the interest held by investors in the underlying exposures of the securitization transaction;

“IRB” ( ) means the internal ratings-based approach;

“IRBS” ( ) means the internal ratings-based securitization approach;

“LGD” ( ) means loss given default;

“liquidity facility” ( ), in relation to an authorized institution, means an off-balance sheet securitization exposure of the institution arising from a contractual agreement to provide funding in respect of a securitization transaction to ensure the timeliness of cash flows to an investor;

“long-term ECAI issue specific rating” ( ), in relation to a securitization exposure, means a current long-term credit assessment rating assigned to the exposure by an ECAI;

“long-term inferred rating” ( ), in relation to a securitization exposure, means the exposure has a current long-term credit assessment rating as specified in the definition of “inferred rating”;

“look-through treatment” ( ), in relation to a securitization position held by an authorized institution in a securitization transaction, means a method of determining the risk-weight of the position by reference to –

- (a) subject to *paragraph (b)*, the risk-weight applicable to the underlying exposures of the securitization transaction;
- (b) if the underlying exposures consist of different types of exposure, the weighted average risk-weight applicable to the underlying exposures of the securitization transaction,

using the BSA or STC to calculate the credit risk of the underlying exposures of the securitization transaction;

“loss given default” ( ), in relation to an exposure of an authorized institution, means the loss expected to be incurred by the institution on the



exposure upon the default of the obligor relative to the amount outstanding at default;

“non-securitization exposure” ( ), in relation to an authorized institution, means an exposure of the institution which is not a securitization exposure;

“originating institution” ( ), in relation to a securitization transaction, means the originator is an authorized institution;

“originator” ( ), in relation to a securitization transaction, means a person who –

- (a) directly or indirectly originates the underlying exposures included in the securitization transaction; or
- (b) serves as a sponsor of an ABCP programme or a programme with similar features;

“potential exposure” ( ), in relation to a securitization exposure arising from an interest rate or exchange rate contract, means the principal amount of the contract multiplied by the applicable CCF;

“principal amount” ( ) means -

- (a) in relation to an on-balance sheet securitization exposure of an authorized institution, the current book value of the exposure;
- (b) in relation to an off-balance sheet securitization exposure of an authorized institution, the contracted amount of the exposure or, in the case of an exposure which is a partially drawn facility, the amount of the undrawn commitment,

which shall be measured -

- (c) after deduction of specific provisions under the use of the STS to calculate the institution's credit risk;
- (d) without deduction of specific provisions and partial write-offs under the use of the IRBS to calculate the institution's credit risk.

“rated” ( ), in relation to a securitization exposure, means the exposure has –

- (a) an ECAI issue specific rating;
- (b) if *paragraph (a)* does not apply, an inferred rating;

“ratings-based method” ( ), in relation to the use of the IRBS to calculate an authorized institution's credit risk for rated securitization exposures, means the method of calculating that risk set out in *Division [..] of Part 7*;

“RBM” ( ) means the ratings-based method;

“regulatory capital” ( ), in relation to a securitization exposure of an authorized institution, means the amount of capital the institution is required to hold in respect of the risk-weighted amount of the exposure;

“second loss tranche” ( ), in relation to a securitization transaction, means a securitization position which benefits from the credit enhancement of the first loss tranche;

“securitization exposure” ( ), in relation to an authorized institution, means the institution's exposure to a securitization transaction in its banking book, and includes such an exposure arising from –

- (a) the purchase or acquisition of securitization issues for investment purposes;
- (b) the provision of credit protection or credit enhancement to any of the parties to the securitization transaction;
- (c) the retention of one or more than one securitization position;
- (d) the provision of a liquidity facility or similar facility for the securitization transaction;
- (e) the repurchase of securitization issues; and
- (f) the obligation to acquire any investors' interest in the securitization transaction with an early amortization provision;

“securitization issues” ( ), in relation to a securitization transaction, means the securities issued by the issuer in the securitization transaction;

“securitization position” ( ), in relation to an authorized institution, means an exposure of the institution to one of the different tranches in a securitization transaction;

“securitization transaction” ( ), means a transaction involving the tranching of credit risk associated with a pool of underlying exposures and in respect of which –

- (a) there are not less than 2 different tranches;
- (b) payments to investors or other parties under the transaction depend on the performance of the underlying exposures; and
- (c) the subordination of tranches determines the distribution of losses during the life of the transaction;

“servicer cash advance facility” ( ), in relation to an authorized institution, means an off-balance sheet securitization exposure of the institution arising from a contractual agreement to provide funding in respect of a securitization transaction to ensure an uninterrupted flow of payments to investors in the securitization issues in the securitization transaction;

“SFM” ( ) means the supervisory formula method;

“short-term ECAI issue specific rating” ( ), in relation to a securitization exposure, means a current short-term credit assessment rating assigned to the exposure by an ECAI;

“short-term inferred rating” ( ), in relation to a securitization exposure, means the exposure has a current short-term credit assessment rating as specified in the definition of “inferred rating”;

“SPE” ( ) means a special purpose entity;

“special purpose entity” ( ) means a company, trust or other entity –

- (a) created for a specific purpose;
- (b) the activities of which are limited to those appropriate to accomplish that purpose; and
- (c) the structure of which is intended to isolate the company, trust or other entity, as the case may be, from the credit risk of an originator or seller of underlying exposures;

“specific provisions” ( ), in relation to an authorized institution's on-balance sheet or off-balance sheet exposures, mean –

- (a) an allowance for impairment loss of financial assets that are individually assessed for impairment in accordance with Hong Kong Accounting Standard 39; and
- (b) provisions made in accordance with Hong Kong Accounting Standard 37;

“sponsor” ( ), in relation to an ABCP programme or a programme with similar features, means a person who establishes the programme and manages, or participates in the management of, the programme by performing one or more than one of the following activities -

- (a) approving the sellers to be permitted to participate in the programme;
- (b) approving the pool of underlying exposures to be purchased under the programme;
- (c) administering the programme, including arranging for the placement into the market of securities issued under the programme; or
- (d) providing any credit enhancement or liquidity facility in respect of the programme;

“standardized approach” ( ) –

- (a) in relation to the calculation of an authorized institution's credit risk for non-securitization exposures, means the method of calculating that risk set out in *Division [..] of Part 4*;

(b) in relation to the calculation of an authorized institution's operational risk, means the method of calculating that risk set out in *Division 2 of Part 5*;

“standardized approach for securitization” ( ), in relation to the calculation of an authorized institution's credit risk for securitization exposures, means the method of calculating that risk set out in *Division [..] of Part 7*;

“STC” ( ), in relation to the calculation of an authorized institution's credit risk for non-securitization exposures, means the standardized approach;

“STS” ( ) means the standardized approach for securitization;

“supervisory formula” ( ) means *Formula 2* set out in *section 17*;

“supervisory formula method” ( ), in relation to the use of the IRBS to calculate an authorized institution's credit risk for securitization exposures which are unrated, means the method of calculating that risk set out in *Division 7 of Part 7*;

“synthetic securitization” ( ) means a securitization transaction where the credit risk of a pool of underlying exposures is transferred, in whole or in part, through the use of funded or unfunded credit protection that serves to hedge the credit risk of the underlying exposures which remain on the balance sheet of the originator;

“traditional securitization” ( ) means a securitization transaction where –

(a) a pool of underlying exposures is sold by the originator to a bankruptcy-remote SPE; and

- (b) the cash flows from the pool of underlying exposures are used to service payments to investors or other parties under the transaction.

“tranche” ( ) means a contractually established segment (“relevant segment”) of the credit risk associated with a pool of underlying exposures in a securitization transaction where –

- (a) a position in the relevant segment entails a risk of credit loss greater than, or less than, that of a position of the same amount in each other contractually established segment; and
- (b) no account is taken of credit protection provided by third parties directly to the holders of positions in the relevant segment or in other contractually established segments;

“uncommitted” ( ), in relation to a credit line extended by an authorized institution to an obligor, means the line is unconditionally cancellable by the institution without prior notice to the obligor;

“underlying exposures” ( ), in relation to a securitization transaction, means one or more than one on-balance sheet or off-balance sheet exposure in respect of which the credit risk is transferred to one or more than one person by the originator in the securitization transaction;

“undrawn balances” ( ), in relation to the calculation of investors' interest, mean the amounts of revolving credit lines that have not been drawn by the obligors of the credit lines, where –

- (a) the credit lines have been sold into a securitization transaction; and

- (b) the investors remain, in whole or in part, exposed to future drawings by the obligors under the credit lines available to the obligors;

“unfunded credit protection” ( ), in relation to a credit exposure of an authorized institution, means a technique of credit risk mitigation where the reduction in credit risk of the exposure is derived from the institution realizing the undertaking of a third party (including that under a guarantee or a credit default swap) to pay an amount in the event of –

- (a) the default of an obligor in respect of the exposure; or
- (b) the occurrence of another specified credit event relating to that obligor;

“unrated” ( ), in relation to a securitization exposure, means the exposure is not a rated exposure;

“weighted average risk-weight” ( ), in relation to a securitization transaction where the underlying exposures consist of different types of exposure, means the average risk-weight of the pool of exposures derived by taking the risk-weight of each type of exposure weighted to reflect the proportion of the principal amount of the type of exposure concerned to the aggregate principal amount of the exposures in the pool.

(2) For the avoidance of doubt, it is hereby declared that no reference in these Rules to a securitization transaction shall be construed as excluding a reference to a securitization transaction which has more than one originating institution or more than one SPE.



## PART 2

### APPLICATION OF THESE RULES

#### 3. Calculation of credit risk for securitization exposures

- (1) Subject to *subsections (2) and (3) and section 4*, an authorized institution shall –
  - (a) only use the STS to calculate its credit risk for securitization exposures in a securitization transaction if –
    - (i) it uses the STC to calculate its credit risk for the type of exposures that is the same as the type of underlying exposures; or
    - (ii) it uses the BSA to calculate its credit risk for the type of exposures that is the same as the type of underlying exposures;
  - (b) only use the IRBS to calculate its credit risk for securitization exposures in a securitization transaction if it uses the IRB to calculate its credit risk for the type of exposures that is the same as the type of underlying exposures.
- (2) Where a securitization transaction has –
  - (a) 2 or more types of underlying exposures; and
  - (b) an authorized institution which holds a securitization exposure in respect of the securitization transaction uses any combination of the STC, IRB or BSA to calculate its credit risk for those types,

then the institution shall, after consultation with the Monetary Authority and unless otherwise directed by the Monetary Authority -

- (c) use the STS to calculate its credit risk for the securitization exposure if the STC or BSA is used to calculate its credit risk for the majority of those types;
- (d) use the IRBS to calculate its credit risk for the securitization exposure if the IRB is used to calculate its credit risk for the majority of those types.

(3) Where an authorized institution holds a securitization exposure in a securitization transaction and uses the IRB to calculate its credit risk; and –

- (a) [provision not used]
- (b) the IRB has no specific treatment for exposures of the same type as the type of underlying exposures in the securitization transaction;  
or
- (c) the institution does not have the prior consent of the Monetary Authority to use the IRB to calculate its credit risk for the type of exposures that is the same as the type of underlying exposures in the securitization transaction,

then the institution shall use the STS to calculate its credit risk for the securitization exposures in the securitization transaction.

(4) For the purposes of *subsection (2)*, an authorized institution shall determine which is the majority of the types of underlying exposures referred to in that subsection by reference to, for each type of underlying exposures, the principal amount of

on-balance sheet exposures and the credit equivalent amount of off-balance sheet exposures under the use of the STC by the institution, or the EAD of off-balance sheet exposures under the use of the IRB by the institution, as the case requires.

**4. Use of RBM or SFM to calculate credit risk for securitization exposures under IRBS**

An authorized institution which uses the IRBS to calculate its credit risk for securitization exposures –

- (a) shall use the RBM to calculate the risk-weighted amount of its rated securitization exposures;
- (b) subject to *paragraph (c)*, shall, with the prior consent of the Monetary Authority, use the SFM to calculate the capital charge for its unrated securitization exposures;
- (c) subject to *paragraph (d)*, shall deduct from its capital base any unrated securitization exposure of the institution in respect of which the SFM cannot be used to calculate the institution's credit risk for the exposure because the institution lacks the consent referred to in *paragraph (b)* or because of any other reason;
- (d) may, with the prior consent of the Monetary Authority, apply the method specified in *section 25(3)* on an exceptional or temporary basis to calculate the risk-weighted amount of unrated eligible liquidity facilities extended by the institution.

## PART 7

### SECURITIZATION

#### *Division 1 – General*

#### **5. Treatment to be accorded securitization transaction by originating institution**

(1) Subject to *subsection (2)*, an originating institution in a securitization transaction may, with the prior consent of the Monetary Authority –

- (a) in the case of a traditional securitization where all the requirements of *Schedule 1* applicable to or in relation to the institution and the securitization transaction have been fulfilled, exclude the underlying exposures from the calculation of its credit risk;
- (b) in the case of a synthetic securitization where all the requirements of *Schedule 2* applicable to or in relation to the institution and the securitization transaction have been fulfilled, calculate the risk-weighted amount of the underlying exposures in accordance with *Division 10*.

(2) Notwithstanding that a securitization transaction falls within *subsection (1)*, the originating institution shall hold [regulatory capital] against any securitization exposure that it retains, holds or purchases under the securitization transaction.

(3) Subject to *subsection (4)*, the originating institution in a traditional securitization that does not fall within *subsection (1)(a)* shall risk-weight the underlying

exposures in accordance with that approach to the calculation of its credit risk that it uses for the type of exposures that is the same as the type of the underlying exposures.

(4) Notwithstanding that a traditional securitization does not fall within *subsection (1)(a)*, the originating institution of the securitization transaction shall not include in its capital base any gain-on-sale arising from the transaction.

(5) The originating institution in a synthetic securitization that does not fall within *subsection (1)(b)* shall risk-weight the underlying exposures -

- (a) by not taking into account the effect of any credit risk mitigation in respect of the underlying exposures; and
- (b) in accordance with that approach to the calculation of its credit risk that it uses for the type of exposures that is the same as the type of the underlying exposures.

**[5A. Provision not used.]**

**6. Action that may be taken by Monetary Authority if originating institution provides implicit support**

(1) The originating institution in a securitization transaction falling within *section 5(1)* shall not provide implicit support to investors in the securitization transaction.

(2) Where the originating institution in a securitization transaction provides implicit support in contravention of *subsection (1)*, then the Monetary Authority may, after having had regard to the materiality of the contravention –

(a) require the institution to not use (or, where applicable, withdraw any consent of the Monetary Authority for the institution to use)

*section 5(1)(a)* or *(b)*, or *section 5(1)(a)* and *(b)* -

(i) for that securitization transaction; or

(ii) for other securitization transactions in respect of which the institution is the originating institution and for such period, or until the occurrence of such event, as is specified by the Monetary Authority in the requirement;

(b) require the institution to publicly disclose particulars of the implicit support and its impact on the institution's regulatory capital; or

(c) advise the institution that the Monetary Authority is considering exercising the power under section 101 of the Ordinance to vary the capital adequacy ratio of the institution by increasing it.

(3) The originating institution in a securitization transaction shall comply with a requirement given to it under *subsection (2)(a)* or *(b)*.



(4) Where -

- (a) a securitization transaction contains a clean-up call; and
- (b) the clean-up call can be exercised by the originating institution in such a way that it thereby provides credit enhancement,

then the clean-up call shall be treated as implicit support and the provisions of these Rules relating to implicit support shall apply accordingly.

## ***Division 2 – Calculation of regulatory capital for securitization exposures***

### **7. Calculation of risk-weighted amount**

(1) Subject to *subsections (2) to (6)*, an authorized institution shall calculate the risk-weighted amount of a securitization exposure held by it by applying the relevant risk-weight to the principal amount of the exposure by reference to its ECAI issue-specific rating or otherwise in accordance with these Rules.

(2) Subject to *subsections (4) and (5)*, an authorized institution shall calculate the risk-weighted amount of an on-balance sheet securitization exposure –

- (a) if the institution uses the STS or the RBM to calculate its credit risk for that exposure, by multiplying the principal amount of the exposure by the applicable risk-weight;
- (b) if the institution uses the SFM to calculate its credit risk for that exposure, by multiplying the amount of capital charge calculated in respect of the exposure by 12.5.

(3) Subject to *subsections (4) and (5)*, an authorized institution shall calculate the risk-weighted amount of an off-balance sheet securitization exposure –

- (a) if the institution uses the STS or RBM to calculate its credit risk for that exposure, by –
  - (i) converting the exposure into a credit equivalent amount by multiplying the principal amount of the exposure by the applicable CCF; and

- (ii) multiplying that credit equivalent amount by the applicable risk-weight;
- (b) if the institution uses the SFM to calculate its credit risk for that exposure, by –
  - (i) multiplying the capital charge calculated in respect of the exposure by 12.5; and
  - (ii) multiplying the risk-weighted amount obtained under *subparagraph (i)* by the applicable CCF;
- (c) unless otherwise specified in *Division 5, 6, 8 or 9*, by applying a CCF of 100% to the exposure.

(4) Where a securitization exposure held by an authorized institution is subject to funded or unfunded credit protection, the institution shall adjust the regulatory capital for the exposure in accordance with *Division 11*.

(4A) If an authorized institution other than the originating institution in a securitization transaction provides credit protection to a securitization issue, the institution providing the credit protection shall calculate its regulatory capital in respect of the credit protection as if it were an investor in the securitization issue.

(4B) If an authorized institution other than the originating institution in a securitization transaction provides credit protection to an unrated credit enhancement, the institution providing the credit protection shall calculate its regulatory capital in respect of the credit protection as if it directly provided the unrated enhancement.

(5) Where an authorized institution provides 2 or more overlapping facilities in respect of a securitization transaction, the institution shall, to the extent that the

facilities overlap, include in its risk-weighted amount only the facility, or the part of the facility, that produces the higher risk-weighted amount, in accordance with *section 27*.

(6) An authorized institution shall use the aggregate risk-weighted amount of its securitization exposures calculated under the IRBS for the purpose of calculating its capital adequacy ratio only after multiplying that amount by a scaling factor specified by the Monetary Authority in *section [..] of Part 4*.

***Division 3 – External credit assessments***

**8. Use of external credit assessments for determination of risk-weights**

Subject to *section 9, sections [..]* of *Part 4* relating to ECAI ratings shall, for the purposes of this Part and with all necessary modifications, apply to and in relation to securitization exposures.

**9. Provision applicable to ECAI ratings in addition to those applicable under [Part 4]**

(1) An authorized institution which uses the STS or RBM to calculate the risk-weighted amount of its rated securitization exposures –

- [(a) provision not used;]
- (b) subject to *paragraphs (c) and (d)*, shall use ECAI issue specific ratings issued by the same ECAIs consistently for a given type of securitization exposure;
- (c) shall not use ECAI issue specific ratings issued by an ECAI for one or more than one securitization position and the ECAI issue specific ratings issued by another ECAI for other securitization positions (whether retained or purchased) that may or may not be rated by the first-mentioned ECAI in respect of the same securitization transaction;
- (d) shall apply *section [..]* where 2 or more ECAIs which may be used have different ECAI issue specific ratings applicable to the same securitization exposure in respect of the same securitization transaction;
- (e) if under a securitization transaction credit protection is -
  - (i) provided directly to the SPE by a credit protection provider falling within *section [..]*; and
  - (ii) reflected in the ECAI issue specific rating assigned to a securitization exposure,

then the institution –

- (iii) shall use the risk-weight determined by reference to that rating; and
- (iv) shall not otherwise recognize, for the purposes of this Part, that credit protection;
- (f) if under a securitization transaction credit protection is provided directly to the SPE by a credit protection provider not falling within *section [..]*, then the institution shall treat the securitization exposure covered by the credit protection as unrated;
- (g) if under a securitization transaction credit protection is not obtained by the SPE but is applied to a specific rated securitization exposure held by the institution (whether a tranche of asset-backed securities or otherwise), then the institution shall –
  - (i) treat the exposure as if it were unrated; and
  - (ii) use the credit risk mitigation treatment –
    - (A) specified in *Part [..]*; or
    - (B) specified in *Part [..]*,

to recognize the effect of the credit protection that applies to that exposure.

#### ***Division 4 - Deductions from capital base***

##### **10. Deductions from capital base**

(1) Subject to *subsection (2)*, an authorized institution shall deduct from its capital base -

- (a) any credit-enhancing I/O recorded by the institution as the originating institution in a securitization transaction (after deduction of any gain-on-sale arising from the credit-enhancing I/O);
- (b) any gain-on-sale arising from a securitization transaction where the institution is the originating institution; or
- (c) if the institution uses the STS to calculate its credit risk for securitization exposures, any rated securitization exposure of the institution with -
  - (i) a long-term credit quality grade of 4 or higher in the case of a securitization exposure held by the institution as the originating institution;
  - (ii) a long-term credit quality grade of 5 in the case of a securitization exposure held by the institution as an investing institution;
  - (iii) a short-term credit quality grade of 4, as allocated under Table A or Table B, as the case may be, of *Schedule 4*;



- (d) if the institution uses the STS to calculate its credit risk for securitization exposures, any unrated securitization exposure of the institution except where the securitization exposure is -
  - (i) the most senior tranche in a securitization transaction that falls within *section 13(1)*;
  - (ii) a second loss tranche or better in an ABCP programme that falls within *section 14*; or
  - (iii) a liquidity facility that falls within *section 23*;
- (e) if the institution uses the RBM [under the IRBS] to calculate its credit risk for securitization exposures, any rated securitization exposure of the institution with a long-term credit quality grade of 12 or a short-term credit quality grade of 4 as allocated, respectively, under Table A or Table B of *Schedule 7*;
- (f) if the institution uses the SFM [under the IRBS] to calculate its credit risk for securitization exposures, any unrated securitization exposure of the institution with a risk-weight of not less than 1250%;
- (g) if the institution uses the IRBS to calculate its credit risk for securitization exposures but cannot use the SFM, or the method specified in *section 25(3)* for liquidity or servicer cash advance facilities, because it lacks the Monetary Authority's consent to do so or because of any other reason, any unrated securitization exposure of the institution; and

- (h) any other securitization exposure specified by the Monetary Authority in a notice in writing [given to the institution].
- (2) An authorized institution required by *subsection (1)* to make a deduction from its capital base shall make the deduction -
- (a) based on -
    - (i) the principal amount of the deductible item if the institution uses the STS to calculate its credit risk for securitization exposures; or
    - (ii) the principal amount of the deductible item (after deduction of any specific provision, partial write-off or non-refundable purchase price discount, as the case may be, made against the deductible item) if the institution uses the IRBS to calculate its credit risk for securitization exposures;
  - (b) subject to *section 23A(1)* of *Part 3* and *paragraph (c)*, 50% from its core capital and 50% from its supplementary capital;
  - (c) in the case of a deduction falling within *subsection (1)(b)*, 100% from its core capital.

***Division 5 – Maximum capital requirement for originating institution***

**11. General**

Notwithstanding any other provision of this Division but subject to *section 30*, the regulatory capital required to be held by the originating institution in a securitization transaction in respect of the securitization exposures retained by it shall not exceed the regulatory capital it would have been required to hold in respect of the underlying exposures if the underlying exposures had not been securitized.

***Division 5A – Risk-weighting requirements under STS***

**12. Determination of risk-weights under STS**

An authorized institution which uses the STS to calculate its credit risk for securitization exposures shall –

- (a) for the purposes of deriving the risk-weights to be used under the STS, map ECAI issue specific ratings to a scale of uniform credit quality grades represented –
  - (i) by the numerals 1, 2, 3, 4 and 5 for long-term ECAI issue specific ratings as specified in Table A set out in *Schedule 4*; and
  - (ii) by the numerals 1, 2, 3 and 4 for short-term ECAI issue specific ratings as specified in Table B set out in *Schedule 4*;
- (b) allocate risk-weights –
  - (i) in accordance with Table A set out in *Schedule 4* in the case of long-term ECAI issue specific ratings; and
  - (ii) in accordance with Table B set out in *Schedule 4* in the case of short-term ECAI issue specific ratings;
- (c) in the case of a securitization exposure of the institution which has a long-term ECAI issue specific rating which maps to a credit quality grade of 4 –

- (i) risk-weight the exposure at 350% if the institution is an investing institution;
  - (ii) deduct the exposure from the institution's capital base if the institution is the originating institution;
- (d) treat all securitization exposures of the institution not falling within *paragraph (c)* the same whether the institution is the originating institution or an investing institution.

**12A. Exceptions to deduction for unrated securitization exposures**

An authorized institution which uses the STS to calculate its credit risk for securitization exposures shall deduct from its capital base all of its unrated securitization exposures except any such exposure falling within *section 13(1), 14 or 23*.

**13. Most senior tranche in securitization transaction**

- (1) Where an authorized institution –
  - (a) holds a securitization position in the most senior tranche in a securitization transaction and the tranche is unrated; and
  - (b) knows the current composition of the pool of underlying exposures,

then the institution shall determine the risk-weight to be allocated to the position by applying the look-through treatment.

[(2) Provision not used.]

[(3) Provision not used.]

[(4) Provision not used.]

(5) Where an authorized institution is determining whether a tranche is the most senior tranche in a securitization transaction, the institution shall disregard –

- (a) any interest rate or exchange rate contract entered into for the purpose of hedging the respective interest rate risk or foreign exchange risk in the securitization transaction; and
- (b) fees or other similar payments due under the securitization transaction.

(6) Where an authorized institution is unable to determine in accordance with this section the risk-weights to be allocated to the underlying exposures referred to in *subsection (1)* because it lacks the knowledge referred to in *paragraph (b)* of that subsection, then it shall deduct the securitization position referred to in that subsection from its capital base.

**14. Securitization positions that are in second loss tranche or better in ABCP programmes**

[Subject to *section [..],*] where –

- (a) an authorized institution holds an unrated securitization position in an ABCP programme;
- (b) the position is [in a tranche which is economically] in a second loss tranche or better in the securitization transaction and the first loss tranche provides credit enhancement to the second loss tranche;
- [(c) the credit risk of the position is [the equivalent of] investment grade; and]
- (d) the institution does not also hold a securitization position in the first loss tranche,

then the institution shall allocate a risk-weight of the greater of –

- (e) 100%; or
- (f) the highest risk-weight which would be allocated, under the approach used by the institution to calculate its credit risk for the type of underlying exposures, to any of the underlying exposures covered by the position.



## ***Division 6 – Risk-weighting requirements under RBM***

### **15. Determination of risk-weights under RBM**

- (1) An authorized institution which uses the RBM to calculate its credit risk for rated securitization exposures shall –
  - (a) for the purposes of deriving the risk-weights to be used under the RBM, map ECAI issue specific ratings to a scale of uniform credit quality grades represented –
    - (i) by the numerals 1 to 12 for long-term ECAI issue specific ratings as specified in Table A set out in *Schedule 7*;
    - (ii) by the numerals 1, 2, 3 and 4 for short-term ECAI issue specific ratings as specified in Table B set out in *Schedule 7*;
  - (b) allocate risk-weights –
    - (i) in accordance with Table A set out in *Schedule 7* in the case of long-term ECAI issue specific ratings; and
    - (ii) in accordance with Table B set out in *Schedule 7* in the case of short-term ECAI issue specific ratings.
- (2) *Subsection (1)* shall apply to and in relation to an inferred rating as it applies to an ECAI issue specific rating.
- (3) An authorized institution which uses the RBM to calculate credit risk for its securitization exposures shall treat a securitization position in a tranche as a senior

position if the tranche is effectively backed or secured by a first legal claim on the entire amount outstanding in respect of the underlying exposures.

(4) For the purposes of determining whether a securitization position in a tranche falls within *subsection (3)*, an authorized institution shall not take account of –

- (a) any interest rate or exchange rate contract entered into for the purpose of hedging the respective interest rate risk or foreign exchange risk in the securitization transaction; and
- (b) fees or other similar payments due under the securitization transaction.

(5) An authorized institution shall allocate the risk-weights specified in Table A set out in *Schedule 7* to its securitization exposures if the exposures have –

- (a) a long-term ECAI issue specific rating; or
- (b) a long-term inferred rating.

(6) An authorized institution shall, in the case of a securitization exposure referred to in *subsection (5)*, allocate –

- (a) the risk-weights specified in *column A* of Table A set out in *Schedule 7* if –
  - (i) the effective number of underlying exposures specified in *subsection (7)* is not less than 6; and
  - (ii) the position falls within *subsection (3)*;
- (b) the risk-weights specified in *column C* of Table A set out in *Schedule 7* if the effective number of underlying exposures specified in *subsection (7)* is less than 6.

(7) For the purposes of *subsection (6)*, an authorized institution shall calculate the effective number of underlying exposures by –

- (a) treating multiple exposures to one obligor as one exposure; and
- (b) subject to *subsection (8)*, the use of *Formula 1*.

**Formula 1**  
**Calculation of N**

$$N = \frac{\left( \sum_i EAD_i \right)^2}{\sum_i EAD_i^2}$$

where:

- $N =$  effective number of underlying exposures (in the case of a re-securitization as specified in *subsection (8)*, the effective number of securitization exposures which have been securitized);
- $EAD_i =$  the exposure at default associated with the  $i^{\text{th}}$  obligor in the pool of underlying exposures.

(8) Where there is a further securitization of securitization exposures (“relevant exposures”) of an authorized institution (“re-securitization”), the institution –

- (a) shall take into account the number of relevant exposures in the pool for the re-securitization instead of the number of underlying exposures in the original pools in the securitization transactions creating the relevant exposures; and
- (b) may, for the purposes of *Formula 1*, if the portfolio share (being the amount of the largest exposure in the pool as a percentage of

the total amount of the pool of the relevant exposures) of the largest exposure (“ $C_1$ ”) is available, compute  $N$  in that formula as  $1/C_1$ .

(9) An authorized institution shall allocate the risk-weights specified in *column B* of Table A set out in *Schedule 7* to all of its securitization exposures which do not fall within *subsection (6)(a)* or *(b)*.

(10) Subject to *subsection (11)*, an authorized institution shall allocate the risk-weights specified in Table B set out in *Schedule 7* to its securitization exposures if the exposures have –

- (a) a short-term ECAI issue specific rating;
- or
- (b) a short-term inferred rating.

(11) *Subsections (6), (7), (8) and (9)* shall, with all necessary modifications, apply to and in relation to any rating referred to in *subsection (10)* and to Table B set out in *Schedule 7* as they apply to and in relation to any rating referred to in *subsection (5)* and to Table A set out in that Schedule.

## **16. Use of inferred ratings**

An authorized institution shall only attribute an inferred rating to a securitization exposure held by it if –

- (aa) the exposure has no applicable ECAI issue specific rating;
- (a) the reference securitization exposure (being an externally rated securitization exposure) is subordinate in all respects to the exposure after taking into account credit enhancements, if any, when assessing the relative subordination of the exposure and the reference securitization exposure;
- (b) the maturity of the reference securitization exposure is not less than that of the exposure;
- (c) the inferred rating is updated from time to time in order to reflect any changes in the ECAI issue specific rating of the reference securitization exposure; and
- (d) the ECAI issue specific rating of the reference securitization exposure fulfils the requirements for recognition of ECAI issue specific ratings as specified in *sections 8 and 9*.

## ***Division 7 – Risk-weighting requirements under SFM***

[17A.] Application] - not used.

### **17. Use of supervisory formula**

(1) An authorized institution shall allocate that risk-weight for each of its unrated securitization exposures that is the greater of –

- (a) 7%; or
- (b) the risk-weight determined under this Division for the exposure.

(2) Subject to *subsections (3), (4) and (6)*, an authorized institution shall, for the purposes of using the supervisory formula to calculate the capital charge for any securitization position in a given tranche of a securitization transaction, determine –

- (a) the capital charge that the underlying exposures would have attracted under the use of the IRB for the calculation of credit risk if the underlying exposures had not been securitized (“ $K_{IRB}$ ”);
- (b) subject to *section 18*, the tranche's credit enhancement level ( $L$ );
- (c) subject to *section 19*, the tranche's thickness ( $T$ );
- (d) subject to *sections 20 and 22*, the pool's effective number of underlying exposures ( $N$ ); and
- (e) subject to *sections 21 and 22*, the pool's exposure-weighted average  $LGD$ .

(3) Subject to *subsection (4)*, an authorized institution shall calculate the capital charge for any securitization position in a tranche of a securitization transaction by multiplying –

- (a) the amount of underlying exposures; by  
 (b) the greater of  $0.0056 \cdot T$  or  $(S[L+T] - S[L])$ ,

where:

function  $S [.] =$  the supervisory formula.

(4) Where an authorized institution holds only a proportional interest in a securitization position in a tranche, the institution shall calculate the capital charge for its interest in the position as equal to its prorated share of the capital charge calculated for the entire tranche.

[(5) Provision not used.]

**Formula 2**  
**Supervisory formula**

$$S[L] = \begin{cases} L & \text{when } L \leq K_{IRB} \\ K_{IRB} + K[L] - K[K_{IRB}] + (d \cdot K_{IRB} / \omega)(1 - e^{\omega(K_{IRB} - L) / K_{IRB}}) & \text{when } K_{IRB} < L \end{cases}$$

where:

$$h = (1 - K_{IRB} / LGD)^N$$

$$c = K_{IRB} / (1 - h)$$

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

$$f = \left( \frac{v + K_{IRB}^2}{1 - h} - c^2 \right) + \frac{(1 - K_{IRB}) K_{IRB} - v}{(1 - h) \tau}$$

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

$$a = g \cdot c$$

$$b = g \cdot (1 - c)$$

$$d = 1 - (1 - h) \cdot (1 - \text{Beta}[K_{IRB}; a, b])$$

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

$$\tau = 1000$$

$$\omega = 20$$

- (6) For the purposes of the supervisory formula –
- (a) Beta [ $L; \alpha, b$ ] is the cumulative beta distribution with parameters  $\alpha$  and  $b$  evaluated at  $L$ ;
  - (b)  $K_{IRB}$  is the ratio, expressed in decimal form, of –
    - (i) the IRB capital charge (including the EL portion) for the pool of underlying exposures –
      - (A) as if those exposures were held directly by the authorized institution concerned; and
      - (B) subject to the effect of any credit protection covering or benefiting those exposures, whether individually or to the entire pool,
    - to -
    - (ii) the sum of drawn amounts in respect of the underlying exposures plus the EAD associated with undrawn commitments in respect of the underlying exposures;
  - (c) if there is an SPE in a securitization transaction, all the assets of the SPE that are related to the securitization transaction shall be treated as underlying exposures in the pool (including assets in the form of a reserve account, whether a cash collateral account or otherwise);
  - (d) if any resulting risk-weight (that is,  $(\text{capital charge} * 12.5) / T$ ) for a securitization exposure is 1250% or above, then the authorized



- institution concerned shall deduct the securitization exposure subject to that risk-weight in accordance with *section 10(1)(d)(ii)*;
- (e) in any case where an authorized institution has set aside a specific provision, or made a partial write-off, in respect of, or has a non-refundable purchase price discount on, an underlying exposure in the pool –
- (i) the amounts referred to in *paragraph (b)* shall be calculated using the gross amount of the underlying exposure without deducting the specific provision, partial write-off or the non-refundable purchase price discount, as the case may be;
- (ii) if the underlying exposure is in default, the amount of the specific provision, partial write-off or non-refundable purchase price discount, as the case may be, may be used to reduce the amount of any deduction from the institution's capital base required to be made in respect of that exposure.

**18. Credit enhancement level of tranche ( $L$ )**

For the purposes of the supervisory formula –

- (a)  $L$  is the ratio, expressed in decimal form, of –
  - (i) the principal amount of all securitization positions subordinate to the tranche concerned,  
to -
  - (ii) the sum of drawn amounts in respect of the underlying exposures plus the EAD associated with undrawn commitments in respect of the underlying exposures;
- (b) the authorized institution shall –
  - (i) determine  $L$  before considering the effects of any tranche-specific credit enhancement (including third party guarantees that benefit only a single tranche); and
  - (ii) exclude from the measurement of  $L$  any gain-on-sale or credit enhancing I/Os realized or held by the institution in respect of the securitization transaction concerned;
- (c) subject to *paragraph (d)*, if any interest rate or exchange rate contract, entered into by an authorized institution with another person for the purpose of hedging any interest rate or foreign exchange risk, as the case may be, arising from the securitization position held by the institution, ranks junior for payment to the tranche concerned, then the institution may measure the principal

amount of the contract at its current exposure (without taking into account that contract's potential exposure) in calculating  $L$ ;

- (d) if the current exposure of an interest rate or exchange rate contract cannot be measured, then the authorized institution concerned shall disregard that contract in the calculation of  $L$ ;
- (e) an authorized institution may include in the calculation of  $L$  any reserve account funded by accumulated cash flows from the underlying exposures that is junior to the tranche concerned; and
- (f) an authorized institution shall not include in the calculation of  $L$  any unfunded reserve accounts that are to be funded from future receipts from the underlying exposures.

**19. Thickness of tranche (*T*)**

For the purposes of the supervisory formula –

- (a) *T* is measured as the ratio of –
  - (i) the principal amount of the tranche concerned;to -
  - (ii) the sum of drawn amounts in respect of the underlying exposures plus the EAD associated with undrawn commitments in respect of the underlying exposures; and
- (b) in determining the principal amount of an authorized institution's securitization exposure arising from an interest rate or exchange rate contract entered into by the institution with another person for the purpose of hedging any interest rate or foreign exchange risk, the institution shall –
  - (i) take into account the potential exposure of the securitization exposure; and
  - (ii) if the current exposure of the securitization exposure –
    - (A) is not negative, measure the securitization exposure by aggregating the current exposure and the potential exposure;
    - (B) is negative, measure the securitization exposure by using only the potential exposure.

**20. Effective number of underlying exposures (*N*)**

For the purposes of the supervisory formula, the authorized institution shall –

- (a) use *Formula 1* to calculate the effective number of underlying exposures;
- (b) treat multiple exposures to one obligor as one exposure; and
- (c) if the securitization is a re-securitization, use *Formula 1* in accordance with *section 15(8)*.

## 21. Exposure-weighted average *LGD*

For the purposes of the supervisory formula –

- (a) the authorized institution shall use *Formula 3* to calculate the exposure-weighted average *LGD*;
- (b) if the securitization is a re-securitization, the authorized institution shall apply an *LGD* of 100% to the relevant exposures in the pool for the re-securitization;
- (c) subject to *paragraph (d)*, if the underlying exposures of a securitization transaction are purchased receivables and the default risk and dilution risk for the purchased receivables are treated by the institution in an aggregate manner (whether by means of the institution holding a single reserve or over-collateralization being available to the institution to cover losses from either default or dilution risk or by other means), the institution shall, for the purposes of the *LGD* to be used in *Formula 3* for calculating the exposure-weighted average *LGD*, first determine the *LGD* [as] a weighted average of the *LGD* for default risk and a 100% *LGD* for dilution risk;
- (d) the authorized institution shall determine the respective weights of default risk and dilution risk referred to in *paragraph (c)* by reference to the proportion that the capital charge calculated for that default risk and the capital charge calculated for that dilution risk respectively bear to the aggregate capital charge calculated for

default risk and dilution risk under the use of the IRB to calculate credit risk in respect of the underlying exposures.

**Formula 3**

**Calculation of exposure-weighted average LGD**

$$LGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where:

$LGD_i$  = the average  $LGD$  associated with  $i^{\text{th}}$  obligor in the pool of underlying exposures; and

$EAD_i$  = the exposure of default associated with the  $i^{\text{th}}$  obligor in the pool of underlying exposures.

## 22. Simplified method for calculating $N$ and $LGD$

For the purposes of the supervisory formula –

- (a) if the amount outstanding under the largest exposure,  $C_1$ , in the pool of underlying exposures is no more than 0.03 or 3% of the aggregate amount of all the underlying exposures in the pool, then the authorized institution may set  $LGD$  at 0.50 and, if so,  $N$  is calculated by the use of *Formula 4*;

### Formula 4

#### Simplified method for computing $N$

$$N = \left( C_1 C_m + \left( \frac{C_m - C_1}{m - 1} \right) \max \{1 - m C_1, 0\} \right)^{-1}$$

where:

[ $C_m$  = the share of the pool of underlying exposures corresponding to the sum of the largest “ $m$ ” exposures (for example, a 15% share corresponds to a value of 0.15) and the level of “ $m$ ” is set by the authorized institution making the regulatory capital calculation];

- (b) if only  $C_1$  is known to the authorized institution and this amount is no more than 0.03, the institution may set  $LGD$  at 0.50 and  $N = 1/C_1$ ; and



- (c) if the underlying exposures are retail exposures, then the authorized institution may use a value for  $h$  of zero and a value for  $\nu$  of zero.]

## **Division 8 – Treatment of liquidity/servicer cash advance facilities**

### **23. Eligible liquidity facilities**

A liquidity facility provided by an authorized institution, which forms part of a securitization transaction, is an eligible liquidity facility [for the purposes of [...]]

where –

- (a) subject to *paragraph (b)*, the facility documentation clearly identifies and limits the circumstances under which the facility may be drawn;
- (b) drawings under the facility are limited to the amount that is likely to be repaid fully from the liquidation of the underlying exposures and any credit enhancements provided by the originator of the underlying exposures;
- (c) the facility is not able to be drawn so as to provide credit support to cover losses already incurred in respect of the pool of underlying exposures prior to the drawing;
- (d) the facility is neither –
  - (i) used to provide permanent or regular funding to investors in the securitization issues; nor
  - (ii) structured such that drawdown is certain, as indicated by regular or continuous drawings;
- (e) the facility is subject to an asset quality test that precludes it from being drawn to cover underlying exposures that are in default as

defined in the IRB, regardless of whether the STS or IRBS is used to calculate credit risk for securitization exposures;

- (f) if the securitization issues supported by the facility are rated, the facility can only be drawn to make payment in respect of those securitization issues that are rated as investment grade at the time of drawdown;
- (g) the facility is not capable of being drawn after all applicable (whether securitization transaction-specific or programme-wide) credit enhancements from which the facility would benefit have been exhausted; and
- (h) repayment of drawings on the facility is not subordinated to the claims of investors in the securitization issues or subject to deferral or waiver by the authorized institution that extends the facility.

**24. Liquidity facilities under STS**

(1) Subject to *subsection (2)*, an authorized institution which uses the STS to calculate its credit risk for securitization exposures shall -

- (a) in the case of a liquidity facility provided by it which is rated (whether or not it is an eligible liquidity facility) –
    - (i) apply *Schedule 4* to the facility; and
    - (ii) apply a CCF of 100% to the facility;
  - (b) in the case of an eligible liquidity facility provided by it which is unrated –
    - (i) apply to the facility the highest risk-weight that would be applied to any of the underlying exposures covered by the facility as determined pursuant to the approach used by the institution to calculate its credit risk for the type of underlying exposures; and
    - (ii) apply a CCF to the facility of –
      - (A) 20% if the facility has an original maturity of not more than one year;
      - (B) 50% if the facility has an original maturity of more than one year.
- (2) Where an eligible liquidity facility provided by an authorized institution –
- (a) is only available in the event of a general market disruption such that more than one SPE in different securitization transactions are unable to roll over maturing commercial paper and that inability is

not the result of an impairment in the credit quality of the SPE in the securitization transaction to which the liquidity facility relates or in the credit quality of the underlying exposures; and

- (b) only advances funds to pay investors in the securitization issues concerned that –
  - (i) are secured by the underlying exposures; and
  - (ii) rank not less than *pari passu* with the claims of those investors,

then the institution may apply a CCF of 0% to the facility.

(3) Where a liquidity facility provided by an authorized institution does not fall within *subsection (1)(a)* or *(b)* or *(2)*, the institution shall –

- (a) apply a CCF of 100% to the facility; and
- (b) deduct the principal amount of the facility from its capital base.

## 25. Liquidity facilities under IRBS

(1) An authorized institution which uses the IRBS to calculate its credit risk for securitization exposures shall –

- (a) in the case of a liquidity facility provided by it which is rated (whether or not it is an eligible liquidity facility)–
  - (i) apply [*Schedule 7*] to the facility; and
  - (ii) apply a CCF of 100% to the facility;
- (b) in the case of an eligible liquidity facility provided by it which is unrated and for which no inferred rating is available –
  - (i) use the SFM to calculate the facility's capital charge;
  - (ii) subject to *subparagraph (iii)*, apply a CCF of 100% to the facility;
  - (iii) apply a CCF of 20% to the facility if the facility can only be drawn as specified in *section 24(2)*.

[(2) Provision not used.]

(3) Where an authorized institution satisfies the Monetary Authority that it is not practicable for the institution to calculate  $K_{IRB}$  for the purpose of applying the supervisory formula, the institution may, with the prior consent of the Monetary Authority, and until the expiration of such period, or the occurrence of such event, as is specified in that consent, calculate the risk-weighted amount of an eligible liquidity facility by –

- (a) applying to the facility the highest risk-weight that would be applied under the use of the STC to calculate credit risk (or the

BSA, if the institution adopts the BSA during its transition to the use of the IRB) to any of the underlying exposures covered by the facility had they not been securitized; and

- (b) applying a CCF of –
  - (i) subject to *subparagraph (iii)*, 50% to the principal amount of the facility if the facility has an original maturity of not more than one year;
  - (ii) subject to *subparagraph (iii)*, 100% to the principal amount of the facility if the facility has an original maturity of more than one year;
  - (iii) 20% to the principal amount of the facility if the facility can only be drawn as specified in *section 24(2)*.

(4) Where a liquidity facility provided by an authorized institution does not fall within *subsection (1)(a)* or *(b)* or *(3)*, then the institution shall deduct the principal amount of the facility from its capital base after deduction of any specific provision or partial write-off.

**26. Servicer cash advance facilities**

(1) Subject to *subsection (2)* and *section [..]*, where a servicer cash advance facility provided by an authorized institution in respect of a securitization transaction, the institution is entitled to full reimbursement of cash advanced under the facility and the entitlement is senior to other claims on cash flows from the pool of underlying exposures, *sections 23, 24 and 25* shall, with all necessary modifications, apply to the determination of the risk-weight and CCF of that servicer cash advance facility as they apply to a liquidity facility.

(2) Where the facility is unconditionally cancellable by the institution without prior notice to the person to whom the facility is provided, then the institution may apply a CCF of 0% to the facility.

(a) [provision not used]

(b) [provision not used]



**27. Overlapping facilities**

(1) Where an authorized institution provides 2 or more facilities that may be drawn in respect of the same securitization transaction such that –

- (a) duplicate coverage is provided in respect of the same underlying exposure (“overlapping portion”); and
- (b) a drawing on one such facility precludes the drawing, whether in whole or in part, on another such facility,

then –

- (c) that institution, for the purposes of these Rules, is required to –
  - (i) provide regulatory capital for the overlapping portion on the basis of -
    - (A) if the facilities are subject to the same CCF, attributing the overlapping portion to any one of the facilities;
    - (B) if the facilities are subject to different CCFs, attributing the overlapping portion to the facility with the highest CCF; and
  - (ii) provide regulatory capital for that portion of each of the facilities that is not the overlapping portion.

(2) Where overlapping facilities are provided by different authorized institutions, then each institution shall hold regulatory capital for the maximum amount of the facility.

*Division 9 –*

**Treatment of securitization exposures with early amortization provision**

**28. Additional capital requirements for originating institutions**

(1) Subject to *subsection (3)* and *section 29*, the originating institution in a securitization transaction shall hold regulatory capital against all or a portion of the investors' interest when –

- (a) it sells underlying exposures into a structure for the securitization transaction that contains an early amortization provision; and
- (b) the underlying exposures are of a revolving nature such that the obligor is permitted to vary the drawn amount and repayments within an agreed limit under a credit line.

[(2) Provision not used.]

(3) Where a securitization transaction has a pool of underlying exposures comprising revolving exposures and term exposures, the originating institution shall apply the relevant early amortization treatment specified in *sections 30 to 34* to that portion of the pool containing the revolving exposures.

## **29. Exemption from early amortization treatment**

The originating institution in a securitization transaction is not required to hold regulatory capital pursuant to *section 28(1)* in any case where –

- (a) the securitization transaction includes a replenishment structure under which the underlying exposures that are revolving in nature are to be replenished by exposures that do not revolve and the early amortization ends the ability of the institution to add new underlying exposures;
- (b) the securitization transaction contains an early amortization provision that results in the structure of the securitization transaction being akin to a term structure in that the credit risk in respect of the underlying exposures does not return to the institution;
- (c) investors in the securitization issues remain fully exposed to future drawings by obligors in respect of the underlying exposures that are revolving in nature such that the credit risk of those exposures does not return to the institution notwithstanding that an early amortization event has occurred; or
- (d) the early amortization provision is solely triggered by events not related to the performance of the underlying exposures that are revolving in nature or of the institution.

**30. Maximum regulatory capital for investors' interest**

The originating institution in a securitization transaction which is subject to early amortization treatment shall hold regulatory capital for the investors' interest to the extent of the greater of –

- (a) the regulatory capital required to be held by the institution for its retained securitization exposures;
- (b) the regulatory capital required to be held by the institution had the underlying exposures not been securitized.

### **31. Investors' interest**

For the purposes of this Division –

- (a) the investors' interest for the originating institution in a securitization transaction using the STS to calculate credit risk for its securitization exposures consists of the investors' share of -
  - (i) the principal amount of the drawn balances of the underlying exposures; and
  - (ii) the credit equivalent amount of the undrawn balances of the underlying exposures determined by allocating the undrawn balances of the underlying exposures between the institution and investors based on the proportion of their respective share of the drawn balances of the underlying exposures;
  
- (b) the investors' interest for the originating institution in a securitization transaction using the IRBS to calculate credit risk for its securitization exposures consists of the investors' share of –
  - (i) the principal amount of the drawn balances of the underlying exposures; and
  - (ii) the EAD of the undrawn balances of the underlying exposures determined by allocating the undrawn balances of securitization exposures between the institution and investors based on the proportion of their respective share of the drawn balances of the underlying exposures.

**32. Mechanics of calculating regulatory capital for investors' interest**

(1) An originating institution in a securitization transaction using the STS to calculate its credit risk for securitization exposures shall calculate the risk-weighted amount of the investors' interest as the product of –

- (a) the investors' interest;
- (b) the appropriate CCF determined under *sections 33 and 34*; and
- (c) the risk-weight applicable to the underlying exposures (or, if there is more than one type of underlying exposure, the weighted average risk-weight of all of the types of underlying exposures) under the approach used by the originating institution to calculate its credit risk for the type of underlying exposures as if the exposures had not been securitized.

(2) An originating institution in a securitization transaction using the IRBS to calculate its credit risk for securitization exposures shall calculate its capital charge for the investors' interest as the product of –

- (a) the investors' interest;
- (b) the appropriate CCF determined under *sections 33 and 34*; and
- (c)  $K_{IRB}$ .

**32A. Meaning of controlled early amortization provision, etc.**

For the purposes of this Division, an early amortization provision –

- (a) is controlled if –
  - (i) the originating institution in a securitization transaction has an appropriate plan which operates to ensure that it has sufficient capital and liquidity available in the event of an early amortization in respect of the securitization transaction;
  - (ii) throughout the duration of the securitization transaction, including the early amortization period, the same pro-rata sharing of payments between the originating institution and investors of interest, principal, expenses, losses and recoveries is applied, based on the relative share of the originating institution and the investors in the drawn balances of the underlying exposures outstanding at the beginning of each month;
  - (iii) the early amortization period set by the originating institution is sufficient for at least 90% of the total debt outstanding under the underlying exposures at the beginning of that period to have been repaid, or to have been recognized by the originating institution as in default by the end of that period; and

- (iv) the speed of repayment of amounts due to the investors by the originating institution is no more rapid than would be the case under a straight-line amortization (being the gradual paying-off of a debt in regular instalments of equal amounts) over the period referred to in *subparagraph (iii)*;
- (b) is non-controlled if it does not fall within *paragraph (a)*.



### 33. CCFs for controlled early amortization provision

For the purposes of determining the CCFs to be applied to the investors' interest in a securitization transaction containing a controlled early amortization provision, an authorized institution shall –

- (a) divide the underlying exposures into committed and uncommitted credit lines;
- (b) apply a CCF of 90% to the investors' interest in respect of the underlying exposures which fall into committed credit lines;
- (c) in respect of the underlying exposures that fall into uncommitted credit lines, further divide the exposures into –
  - (i) non-retail credit lines;
  - (ii) retail credit lines;
- (d) apply a CCF of 90% to the investors' interest in respect of the underlying exposures which fall into uncommitted non-retail credit lines;
- (e) subject to *paragraphs (f) and (g)*, apply the appropriate CCF, determined by reference to the ratio of 3-month average excess spread of the securitization transaction to the trapping point of the excess spread as set out in *Schedule 10*, to the investors' interest in respect of the underlying exposures which fall into uncommitted retail credit lines;
- (f) treat the trapping point of excess spread, for the purposes of *paragraph (e)*, as that point at which the SPE in the securitization

transaction is required to retain the excess spread and not pay it out to the originator; and

- (g) in any case where the securitization transaction does not require excess spread to be trapped, treat as the trapping point that point which is 4.5 percentage points greater than the excess spread level at which an early amortization is triggered.

### **34. CCFs for non-controlled early amortization provision**

For the purposes of determining the CCFs to be applied to the investors' interest in a securitization transaction containing a non-controlled early amortization provision, an authorized institution shall –

- (a) divide the underlying exposures into committed and uncommitted credit lines;
- (b) apply a CCF of 100% to the investors' interest in respect of the underlying exposures which fall into committed credit lines;
- (c) in respect of the underlying exposures that fall into uncommitted credit lines, further divide the exposures into –
  - (i) non-retail credit lines;
  - (ii) retail credit lines;
- (d) apply a CCF of 100% to the investors' interest in respect of the underlying exposures which fall into uncommitted non-retail credit lines;
- (e) subject to *paragraphs (f) and (g)*, apply the appropriate CCF, by reference to the ratio of 3-month average excess spread of the securitization transaction to the trapping point of the excess spread as set out in *Schedule 11*, to the investors' interest in respect of the underlying exposures which fall into uncommitted retail credit lines;
- (f) treat the trapping point of excess spread, for the purposes of *paragraph (e)*, as that point at which the SPE in the securitization

transaction is required to retain the excess spread and not pay it out to the originator; and

- (g) in any case where the securitization transaction does not require excess spread to be trapped, treat as the trapping point that point which is 4.5 percentage points greater than the excess spread level at which an early amortization is triggered.

***[Division 9A – Treatment of interest rate and exchange rate contracts***

**34A. Interest rate and exchange rate contracts**

Where an authorized institution has a securitization exposure arising from its entering into an interest rate or exchange rate contract in a securitization transaction, then the institution shall calculate the risk-weighted amount of the contract in accordance with *Division [..] or [..] of Part [..].*

*Division 10 –*

**Treatment of underlying exposures of originating institutions in synthetic  
securitizations**

**35. General**

This Division shall apply to the calculation by the originating institution in a synthetic securitization that falls within *Schedule 2* of the risk-weighted amount of the entire pool of underlying exposures.

**36. Calculation of risk-weighted amount**

Subject to *section 37*, the originating institution in a synthetic securitization shall –

- (a) subject to *subsections (c) and (d)*, calculate the risk-weighted amount of its underlying exposures for all tranches in the synthetic securitization based on the approach used by the institution to calculate its credit risk for the underlying exposures;
- (b) [provision not used]
- (c) take into account the effect of credit risk mitigation in respect of the underlying exposures in the synthetic securitization in accordance with the credit risk mitigation requirements of *Part 4*; and
- (d) treat the EL amount of the underlying exposures of the institution in the synthetic securitization as zero if the institution uses the IRB to calculate its credit risk.

### 37. Treatment of maturity mismatches

(1) For the purposes of calculating the risk-weighted amount of the originating institution's underlying exposures in a synthetic securitization where there is a maturity mismatch between the credit protection pursuant to which the credit risk is transferred under the securitization transaction and the underlying exposures, the institution –

(a) subject to *paragraph (b)*, shall apply *section [..]*, with all necessary modifications;

and

(b) shall –

(i) take the maturity of the underlying exposures as being the lesser of –

(A) the longest maturity of any of those exposures; or

(B) 5 years;

(ii) determine the maturity of the credit protection in accordance with *section [..] of Part 4;*

(iii) disregard any maturity mismatch in respect of its retained securitization exposures that are subject to deduction from its capital base; and

(iv) for all other securitization exposures, apply the maturity mismatch treatment prescribed in *section [..] of Part 4.*

(2) Where a synthetic transaction incorporates a call option (other than a clean-up call) that is capable, when exercised, of terminating the transaction and the



purchased credit protection on a specified date, the originating institution shall treat the securitization transaction in accordance with the treatment of maturity mismatch specified in *subsection (1)*.

*Division 11 –*

**Recognition of credit risk mitigation for securitization exposures**

**38. General**

For credit risk mitigation to be recognized for the purposes of this Part, it must fall within-

- (a) *section [..];*
- (b) *section [..]; or*
- (c) *section [..].*

**39. [Provision not used]**

**39A. Recognized credit risk mitigation under STS**

The originating institution in a securitization transaction which uses the STS to calculate its credit risk for securitization exposures shall calculate the risk-weighted amount of a securitization exposure in respect of which credit protection has been obtained in accordance with *Division [..]* or *[..]* of *Part [..]*.

#### **40. Recognized credit risk mitigation under RBM**

The originating institution in a securitization transaction which uses the RBM to calculate its credit risk for rated securitization exposures shall calculate the risk-weighted amount of a securitization exposure in respect of which credit protection has been obtained in accordance with *Division [..]* or *[..]* of *Part [..]*.

#### 41. Recognized credit risk mitigation under SFM – full credit protection

(1) The originating institution in a securitization transaction which uses the SFM to calculate its credit risk for unrated securitization exposures shall determine the effective risk-weight of a securitization exposure by dividing the risk-weighted amount of the exposure (being the product of the capital charge calculated for the exposure under the SFM and 12.5) by the principal amount of the exposure and multiplying the result by 100%.

[(2) Where the originating institution in a securitization transaction which uses the SFM has[, pursuant to *subsection (1)*,] determined the effective risk-weight of a securitization exposure, then the institution shall -]

(a) in the case of funded credit protection –

- (i) calculate the risk-weighted amount of the securitization exposure by multiplying the adjusted principal amount of the exposure (after taking into account the credit protection held in respect of it) by that [effective] risk-weight of the exposure;
- [(ii) apply *Division [..]* of *Part [..]* to the treatment and recognition of collateral for sovereign, bank and corporate exposures;]
- [(iii) apply *Division [..]* of *Part [..]* to the treatment and recognition of collateral for retail exposures; and]
- [(iv) apply *Division [..]* of *Part [..]* to the treatment and recognition of collateral for purchased receivables;]]

- (b) in the case of unfunded credit protection –
- (i) calculate the risk-weighted amount of the exposure by multiplying the adjusted amount of the credit protection (after taking into account any currency mismatch and maturity mismatch) by the risk-weight of the credit protection provider and adding this to the amount arrived at by multiplying the principal amount of the exposure, minus the adjusted amount of the credit protection, by that [effective] risk-weight;
  - [(ii) applying *Division [..]* of *Part [..]* to the treatment and recognition of [...] for sovereign, bank and corporate exposures;]
  - [(iii) applying *Division [..]* of *Part [..]* to the treatment and recognition of [...] for retail exposures; and]
  - [(iv) applying *Division [..]* of *Part [..]* to the treatment and recognition of [...] for purchased receivables.]]

**42. Recognized credit risk mitigation under SFM – partial protection**

(1) Where the credit protection for a securitization exposure of an authorized institution using the SFM covers first losses, or losses on a proportional basis in terms of the senior and junior tranches of the exposure, the institution shall –

- (a) only reduce the capital charge of the securitization exposure in respect of that portion of the securitization exposure which is covered by the credit protection; and
- (b) apply *section 41* to the covered portion.

(2) Where the credit protection for a securitization exposure of an authorized institution is partial but not proportional as specified in *subsection (1)*, the institution shall –

- (a) if the amount of credit protection covers all of the senior portion and part of the junior portion –
  - (i) apply the credit protection as against the senior portion first and then apply any remaining credit protection against the junior portion;
  - (ii) treat as the uncovered portion any remaining exposures to which the credit protection does not so apply;
- (b) treat the exposure as 2 or more securitization positions with the uncovered portion being the position with the lower credit quality;
- (c) calculate the risk-weighted amount for the covered portion in accordance with *Division 7*, subject to modifications in respect of the thickness of tranche (*T*) where the principal amount of the



tranche concerned is adjusted for the funded and unfunded credit protection in accordance with *section 41(2)(a)* or *(b)* respectively.

## SCHEDULE 1

[s. 5(1)(a)]

### REQUIREMENTS APPLICABLE TO OR IN RELATION TO ORIGINATING INSTITUTION IN TRADITIONAL SECURITIZATION BEFORE SECTION 5(1)(a) OF THESE RULES MAY BE USED

1. The Monetary Authority is satisfied that significant credit risk associated with the underlying exposures of the securitization transaction has been transferred from the originating institution to third parties.
2. The securitization documentation for the securitization transaction accurately reflects the economic substance of the securitization transaction.
3. An adjudication has been sought and obtained from relevant tax authorities on whether any direct or indirect tax obligations arise as a result of any transfer of interests in underlying exposures and related collateral under the securitization transaction.
4. Subject to *section 5*, the underlying exposures of the securitization transaction have been validly transferred and none of the originating institution's or the institution's creditors, or any liquidator or receiver or like officer appointed in respect of the originating institution, is able, or will be able, to avoid, set aside or successfully contest the transfer.
5. The originating institution has obtained an opinion in writing from qualified legal counsel confirming that, in all relevant jurisdictions, the securitization transaction falls within *section 4*.

6. The transfer of underlying exposures from the originating institution in the securitization transaction does not contravene the terms and conditions of any agreement governing the underlying exposures and all necessary consents have been obtained to make the transfer fully effective.
7. The securitization issues under the securitization transaction do not represent payment obligations of the originating institution such that investors who purchase the securitization issues only have recourse for payment to the pool of underlying exposures.
8. The originating institution does not under the securitization transaction maintain effective control, directly or indirectly, over the underlying exposures.
- [ 9. Provision not used.]
10. The securitization issues under the securitization transaction are issued by the SPE and the holders of the securitization issues have the right to pledge or transfer them without restriction.
11. Where there is a clean-up call, it satisfies the requirements of *Schedule 3*.
12. The securitization documentation for the securitization transaction does not contain any clause that –
  - (aa) directly or indirectly makes any representation or provides any warranty as to the future performance of the credit exposure;
  - (a) obliges the originating institution to repurchase any credit exposure in the underlying exposures, at any time, except where that obligation arises from a claim arising from a representation or warranty given by the originating institution to another person in

the securitization documentation solely in respect of the status of any underlying exposure at the time of the transfer and that is capable of being verified at that time;

- (b) requires the originating institution to alter the pool of underlying exposures such that the pool's weighted average credit quality is improved unless this is achieved through the sale of underlying exposures [by the originating institution] to independent and unaffiliated third parties at market prices;
- (c) allows for increases in a first loss tranche retained, or credit enhancement provided, by the originating institution after the commencement of the securitization transaction; or
- (d) increases the return to parties other than the originating institution, such as investors in securitization issues and third party providers of credit enhancements to the securitization transaction, in response to a deterioration in the credit quality of the pool of underlying exposures.

13. Subject to *section 14*, the originating institution in the securitization transaction has not committed itself to purchasing any of the securitization issues prior to their initial issue by the issuer.

14. Where the originating institution or a member of its group of companies has underwritten any securitization issues in the securitization transaction, this has been done –

- (a) at an arm's length basis; and

(b) after consultation with the Monetary Authority, in accordance with a timetable for the disposal of any positions held or to be held under the underwriting commitment.

15. Where under the securitization transaction there is an interest rate or exchange rate contract between the originating institution and the SPE which issued the securitization issues for the purpose of enabling the SPE to hedge interest rate or foreign exchange risk, that contract was entered into at market rates and, notwithstanding that contract, the securitization transaction still meets the requirements set out in this Schedule.

## SCHEDULE 2

[s. 5(1)(b)]

### REQUIREMENTS APPLICABLE TO OR IN RELATION TO ORIGINATING INSTITUTION IN SYNTHETIC SECURITIZATION BEFORE SECTION 5(1)(b) OF THESE RULES MAY BE USED

1. The Monetary Authority is satisfied that significant credit risk associated with the underlying exposures of the securitization transaction has been transferred from the originating institution to third parties through funded or unfunded credit protection.
2. The securitization documentation for the securitization transaction accurately reflects the economic substance of the securitization transaction.
3. The credit protection by which the credit risk is transferred under the securitization transaction falls within *section [..]* or *[..]* of *Part 4* of these Rules.
4. Subject to *section 5*, where the originating institution –
  - (a) uses the STS to calculate its credit risk for securitization exposures under the securitization transaction, the funded credit protection must fall within *section [..]* of these Rules;
  - (b) uses the IRBS to calculate its credit risk for securitization exposures under the securitization transaction –
    - (i) the funded credit protection must fall within *section [..]* of these Rules in the case of sovereign, bank and corporate exposures;

- (ii) the funded credit protection must fall within *section [..]* of these Rules in the case of retail exposures;
  - (iii) the funded credit protection must fall within *section [..]* of these Rules in the case of purchased receivables.
- 5. The prior consent of the Monetary Authority has been obtained in the case of funded credit protection provided by the SPE in the securitization transaction.
- 6. Subject to *section 7*, where the originating institution –
  - (a) uses the STS to calculate its credit risk for securitization exposures under the securitization transaction, any credit protection provider for unfunded credit protection must fall within *section [..]* of these Rules;
  - (b) uses the IRBS to calculate its credit risk for securitization exposures under the securitization transaction –
    - (i) any credit protection provider for unfunded credit protection must fall within *section [..]* of these Rules in the case of sovereign, bank and corporate exposures;
    - (ii) any credit protection provider for unfunded credit protection must fall within *section [..]* of these Rules in the case of retail exposures;
    - (iii) any credit protection provider for unfunded credit protection must fall within *section [..]* of these Rules in the case of purchased receivables.

7. The SPE in the securitization transaction is not recognized as a credit protection provider for unfunded credit protection for the purposes of credit risk mitigation.
8. The instruments used under the securitization transaction to transfer credit risk do not contain any clause that –
  - (a) materially limits the credit protection or credit risk transference if a credit event occurs or the credit quality of the pool of underlying exposures deteriorates;
  - (b) requires the originating institution to alter the pool of underlying exposures to improve the weighted average credit quality of the pool unless this is achieved through the sale of underlying exposures by the originating institution to independent and unaffiliated third parties at market prices;
  - (c) allows for increases in a first loss tranche retained, or credit enhancement provided, by the originating institution after the commencement of the securitization transaction;
  - (d) allows for increases in the cost of credit protection to the originating institution in response to deterioration in the overall credit quality of the pool of underlying exposures; or
  - (e) increases the return to parties other than the originating institution, such as investors in securitization issues and third party providers of credit enhancements to the securitization transaction, in response to a deterioration in the credit quality of the pool of underlying exposures.



9. The authorized institution has obtained an opinion in writing from qualified legal counsel confirming that, in all relevant jurisdictions, the securitization documentation constitutes valid, legally binding and enforceable obligations of the credit protection provider.
10. Where there is a clean-up call, it satisfies the requirements of *Schedule 3*.
11. Where the originating institution or a member of its group of companies has underwritten any securitization issues in the securitization transaction, this has been done -
  - (a) at an arm's length basis; and
  - (b) after consultation with the Monetary Authority, in accordance with a timetable for the disposal of any positions held or to be held under the underwriting commitment.
12. Where under the securitization transaction there is an interest rate or exchange rate contract between the originating institution and the SPE which issued the securitization issues for the purpose of enabling the SPE to hedge interest rate or foreign exchange risk, that contract was entered into at market rates and, notwithstanding that contract, the securitization transaction still meets the requirements set out in this Schedule.

### SCHEDULE 3

[s. 11 of Schedule 1 and

s. 10 of Schedule 2]

#### REQUIREMENTS APPLICABLE FOR SECURITIZATION TRANSACTIONS

##### THAT INCLUDE CLEAN-UP CALLS

1. Where a securitization transaction which falls within *Schedule 1* or *2* includes a clean-up call, the originating institution of the securitization transaction is not required to hold regulatory capital in respect of the clean-up call if -
  - (a) the exercise of the clean-up call is entirely at the discretion of the originating institution;
  - (b) the clean-up call is not structured –
    - (i) for the purpose of reducing potential or actual losses to investors or other parties to the securitization transaction;  
and
    - (ii) to provide credit enhancement to those investors and parties;  
and
  - (c) the clean-up call is exercisable only when –
    - (i) in the case of a traditional securitization, 10% or less of the principal amount of the securitization issues or underlying exposures at the commencement of the securitization transaction remains outstanding;

- (ii) in the case of a synthetic securitization, 10% or less of the principal amount of the reference pool of underlying exposures at the commencement of the securitization transaction remains outstanding.

**SCHEDULE 4**

[s. 12]

**MAPPING OF ECAI ISSUE SPECIFIC RATINGS INTO CREDIT QUALITY GRADES/RISK-WEIGHTS APPLICABLE UNDER STS**

**TABLE A**

**LONG-TERM CREDIT QUALITY GRADE (LTCQG) AND RISK-WEIGHTS APPLICABLE TO EACH GRADE**

<b>LTCQG</b>	<b>Standard and Poor's Corporation</b>	<b>Moody's Investors Service, Inc.</b>	<b>Fitch Ratings Ltd.</b>	<b>Risk-weight</b>
1	AAA AA+ AA AA-	Aaa Aa1 Aa2 Aa3	AAA AA+ AA AA-	20%
2	A+ A A-	A1 A2 A3	A+ A A-	50%
3	BBB+ BBB BBB-	Baa1 Baa2 Baa3	BBB+ BBB BBB-	100%
4	BB+ BB BB-	Ba1 Ba2 Ba3	BB+ BB BB-	350% (for investing institutions)  [Deduction from capital base (for originating institutions)]

**TABLE A -continued**

<b>LTCQG</b>	<b>Standard and Poor's Corporation</b>	<b>Moody's Investor's Service, Inc.</b>	<b>Fitch Ratings Ltd.</b>	<b>Risk-weight</b>
5	B+	B1	B+	[Deduction from capital base]
	B	B2	B	
	B-	B3	B-	
	CCC+	Caa1	CCC+	
	CCC	Caa2	CCC	
	CCC-	Caa3	CCC-	
	CC	Ca	CC	
	C	C	C	
	D		D	

[NOTE: THE MAPPING LAID OUT IN TABLE A IS FOR ILLUSTRATIVE PURPOSES ONLY.]

**TABLE B**

**SHORT-TERM CREDIT QUALITY GRADE (STCQG) AND RISK-WEIGHTS APPLICABLE TO EACH  
GRADE**

<b>STCQG</b>	<b>Standard and Poor's Corporation</b>	<b>Moody's Investors Service, Inc.</b>	<b>Fitch Ratings Ltd.</b>	<b>Risk-weight</b>
1	A-1	P-1	F-1	20%
2	A-2	P-2	F-2	50%
3	A-3	P-3	F-3	100%
4	Others	Others	Others	[Deduction from capital base]

[NOTE: THE MAPPING LAID OUT IN TABLE B IS FOR ILLUSTRATIVE PURPOSES ONLY.]

**SCHEDULE 5**

**[SCHEDULE NOT USED]**

**SCHEDULE 6**

**[SCHEDULE NOT USED]**



**SCHEDULE 7**

[s. 15]

**MAPPING OF ECAI ISSUE SPECIFIC RATINGS INTO CREDIT QUALITY GRADES/RISK-WEIGHTS APPLICABLE UNDER RBM**

**TABLE A**

**LONG-TERM CREDIT QUALITY GRADES (LTCQG) AND RISK-WEIGHTS APPLICABLE TO EACH GRADE**

LTCQG	Standard and Poor's Corporation	Moody's Investors Service, Inc.	Fitch Ratings Ltd.	Risk-weight		
				A	B	C
1	AAA, AA+	Aaa, Aa1	AAA, AA+	7%	12%	20%
2	AA, AA-	Aa2, Aa3	AA, AA-	8%	15%	25%
3	A+	A1	A+	10%	18%	35%
4	A	A2	A	12%	20%	35%
5	A-	A3	A-	20%	35%	35%
6	BBB+	Baa1	BBB+	35%	50%	50%
7	BBB	Baa2	BBB	60%	75%	75%
8	BBB-	Baa3	BBB-	100%	100%	100%
9	BB+	Ba1	BB+	250%	250%	250%
10	BB	Ba2	BB	425%	425%	425%
11	BB-	Ba3	BB-	650%	650%	650%
12	Below BB- (i.e. B+, B, B-, CCC+, CCC, CCC-, CC, C and D)	Below Ba3 (i.e. B1, B2, B3, Caa1, Caa2, Caa3, Ca and C)	Below BB- (i.e. B+, B, B-, CCC+, CCC, CCC-, CC, C and D)	[Deduction from capital base]		

Where:

risk-weight A denotes risk-weights for senior positions;

risk-weight B denotes risk-weights for securitization positions which do not fall under Column A or Column C; and

risk-weight C denotes risk-weights for tranches backed by non-granular pools (to qualify as granular, the effective number of underlying exposures must be not less than 6).

[NOTE: THE MAPPING LAID OUT IN TABLE A IS FOR ILLUSTRATIVE PURPOSE ONLY.]

**TABLE B**

**SHORT-TERM CREDIT QUALITY GRADES (STCQG) AND RISK-WEIGHTS APPLICABLE TO EACH GRADE**

STCQG	Standard and Poor's Corporation	Moody's Investor Service, Inc.	Fitch Ratings Ltd.	Risk-weight		
				A	B	C
1	A-1	P-1	F-1	7%	12%	20%
2	A-2	P-2	F-2	12%	20%	35%
3	A-3	P-3	F-3	60%	75%	75%
4	All other ratings			[Deduction from capital base]		

Where:

risk-weight A denotes risk-weights for senior positions;

risk-weight B denotes risk-weights for securitization positions which do not fall under Column A or Column C; and

risk-weight C denotes risk-weights for tranches backed by non-granular pools (to qualify as granular, the effective number of underlying exposures must be not less than 6).

[NOTE: THE MAPPING LAID OUT IN TABLE B IS FOR ILLUSTRATIVE PURPOSE ONLY.]

**SCHEDULE 8**

**[SCHEDULE NOT USED]**

**SCHEDULE 9**

**[SCHEDULE NOT USED]**

**SCHEDULE 10**

[s. 2(1)]

**CCFs FOR SECURITIZATIONS SUBJECT TO CONTROLLED EARLY AMORTIZATION  
PROVISION**

	Uncommitted		Committed
Retail credit lines	3-month average excess spread	Credit conversion factor (CCF)	90% CCF
	133.33% or more of trapping point	0% CCF	
	Less than 133.33% to 100% of trapping point	1% CCF	
	Less than 100% to 75% of trapping point	2% CCF	
	Less than 75% to 50% of trapping point	10% CCF	
	Less than 50% to 25% of trapping point	20% CCF	
	Less than 25% of trapping point	40% CCF	
	Non-retail credit lines	90% CCF	

**SCHEDULE 11**

[s. 2(1)]

**CCFs FOR SECURITIZATIONS SUBJECT TO NON-CONTROLLED EARLY AMORTIZATION  
PROVISION**

	Uncommitted		Committed
Retail credit lines	3-month average excess spread	Credit conversion factor (CCF)	100% CCF
	133.33% or more of trapping point	0% CCF	
	Less than 133.33% to 100% of trapping point	5% CCF	
	Less than 100% to 75% of trapping point	15% CCF	
	Less than 75% to 50% of trapping point	50% CCF	
	Less than 50% of trapping point	100% CCF	
Non-retail credit lines	100% CCF		100% CCF

## EXPLANATORY NOTE

### (Asset Securitization only)

#### *Part 2 – Application of these Rules*

1. *Section 3* specifies that an authorized institution must use the standardized approach for securitization (“STS”) to calculate its credit risk for securitization exposures (see *Part 7*) if it uses the standardized approach (“STC”), or the basic approach (“BSA”), to calculate its credit risk for the types of underlying exposures that are securitized. That section also specifies that an authorized institution may only use the internal ratings-based securitization approach (“IRBS”) to calculate its credit risk for securitization exposures (see *Part 7*) if it uses the internal ratings-based approach (“IRB”) to calculate its credit risk for the types of underlying exposures that are securitized. (See the definitions of “standardized approach for securitization”, “securitization exposures”, “standardized approach”, “basic approach”, “underlying exposures”, “internal ratings-based securitization approach” and “internal ratings-based approach” in *section 2(1)*).
2. *Section 4* specifies that an authorized institution which uses the IRBS to calculate its credit risk for securitization exposures shall use the ratings-based method (“RBM”) to calculate the risk-weighted amount of its rated securitization exposures and, with the prior consent of the MA, use the supervisory formula method (“SFM”) to calculate the capital charge for its unrated securitization

exposures. (See the definitions of “ratings-based method”, “rated”, “supervisory formula method” and “unrated” in *section 2(1)*).

### ***Part 7 – Securitization***

3. *Part 7* relates to securitization. Securitization is a form of structured finance which may enable an authorized institution to, inter alia, remove assets from its balance sheet, improve its financial ratios (for example, debt-to-equity, return on capital or return on assets) or raise capital. Securitization transactions fall into 2 categories – traditional securitization or synthetic securitization. (See the definitions of “securitization transaction”, “traditional securitization” and “synthetic securitization” in *section 2(1)*).

### ***Division 1 – General***

4. *Section 5* provides that the originating institution in a traditional securitization may exclude the underlying exposures from the calculation of the risk-weighted amount for its credit exposures and, in a synthetic securitization, may calculate the risk-weighted amount for its credit risk for the underlying exposures in accordance with *Division 10 of Part 7*. However, before the originating institution may do this, it must have the prior consent of the MA, and the requirements of *Schedule 1* to the Rules must be fulfilled in the case of a traditional securitization and the requirements of *Schedule 2* must be fulfilled in the case of a synthetic securitization. (See the definitions of “originating institution” and “originator” in *section 2(1)*).



5. *Section 6* prohibits the originating institution in a securitization transaction from providing implicit support to investors beyond the institution's contractual obligations, and specifies the action that may be taken by the MA if the originating institution contravenes the prohibition. (See the definition of "implicit support" in *section 2(1)*).

***Division 2 – Calculation of regulatory capital under securitization***

6. *Division 2* specifies that an authorized institution shall calculate the risk-weighted amount of a securitization exposure held by it by applying the relevant risk-weight under the STS or IRBS to the exposure by reference to the exposure's ECAI issue specific rating or otherwise in accordance with the Rules.

***Division 3 – External credit assessments***

7. *Section 8* provides that *sections [..]* of *Part 4* relating to ECAI ratings shall, for the purposes of *Part 7* and with all necessary modifications, apply to and in relation to securitization exposures. However, those sections shall only so apply subject to the provisions of *section 9*.

***Division 4 – Deductions from capital base***

8. *Division 4* specifies the deductions that an authorized institution which uses the STS or IRBS shall make from its capital base.

***Division 5 – Maximum capital requirement for originating institution***

9. *Section 11* makes it clear that, subject to *section 30*, the regulatory capital required to be held by the originating institution in a securitization transaction in respect of the securitization exposures retained by it shall not exceed the regulatory capital it would have been required to hold in respect of the underlying exposures if the underlying exposures had not been securitized.

***Division 5A – Risk-weighting requirements under STS***

10. *Section 12*, as read with *Schedule 4* to the Rules, specifies how an authorized institution which uses the STS shall determine the risk-weights to be used under the STS.

***Division 6 – Risk-weighting requirements under RBM***

11. *Section 15*, as read with *Schedule 7* to the Rules, specifies how an authorized institution which uses the RBM shall determine the risk-weights to be used under the RBM. The basis on which an inferred rating may be attributed to a securitization exposure should be noted. (See *section 16*).

***Division 7 – Risk-weighting requirements under SFM***

12. *Section 17(1)* requires an authorized institution to allocate that risk-weight for each of its unrated securitization exposures that is the greater of 7% or the risk-weight determined under *Division 7* for the position concerned. The risk-weight determined under *Division 7* for a position is, essentially, determined by the use

of the supervisory formula (being *Formula 2* set out in *section 17*) as read with the technical provisions of *sections 18* to *22*.

***Division 8 – Treatment of liquidity/servicer cash advance facilities***

13. *Division 8* specifies what constitutes an eligible liquidity facility for the purposes of [*Part 7*] (*section 23*), how an authorized institution which uses the STS or IRBS shall risk-weight its liquidity facilities (*sections 24* and *25*) and how overlapping facilities shall be treated (*section 27*). *Section 26* applies *sections 23*, *24* and *25*, with all necessary modifications, to the determination of the risk-weights and credit conversion factors of servicer cash advance facilities.

***Division 9 – Treatment of securitization exposures with  
early amortization provision***

14. *Division 9* sets out the requirements applicable to securitization transactions which contain an early amortization provision. (See the definition of “early amortization provision” in *section 2(1)* as read with *section 32A* to ascertain the difference between a controlled and a non-controlled early amortization provision). *Section 28(1)* requires the originating institution in such a securitization transaction to hold additional regulatory capital unless the exemption specified in *section 29* is applicable. *Section 28(3)* provides for a special treatment in the case of such a securitization transaction that has a pool of underlying exposures comprising revolving and term underlying exposures.

***Division 9A – Treatment of interest rate and exchange rate contracts***

15. *Division 9A* specifies how an authorized institution shall calculate the risk-weighted amount of an interest rate or exchange rate contract entered into by the institution for the purposes of a securitization transaction.

***Division 10 – Treatment of underlying exposures of originating  
institutions in synthetic securitizations***

16. *Division 10* applies to the calculation by the originating institution in a synthetic securitization that falls within *Schedule 2* of the risk-weighted amount of the

entire pool of underlying exposures. *Section 37* states what the originating institution shall do in the case of a maturity mismatch.

***Division 11 – Recognition of credit risk mitigation for securitization exposures***

17. *Division 11* specifies what is recognized credit risk mitigation for the purposes of *Part 7* and how such recognized credit risk mitigation shall be taken into account in calculating the risk-weighted amounts of securitization exposures.