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## Final report

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EBA Guidelines on the determination of the weighted average maturity (WAM) of the contractual payments due under the tranche in accordance with point (a) of Article 257(1) of Regulation (EU) No 575/2013

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# 1. Executive summary

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1. Regulation (EU) No 575/2013<sup>1</sup> as amended by Regulation (EU) 2017/2401<sup>2</sup> (the Capital Requirements Regulation – CRR) has introduced the maturity of the tranche ( $M_T$ ) as an additional parameter to calculate the capital requirement of securitisation positions. Institutions should use two alternative approaches to determine the maturity of the tranche: (i) the weighted average maturity (WAM) of the contractual payments due under the tranche in accordance with Article 257(1)(a) or (ii) the final legal maturity of the tranche in accordance with Article 257(1)(b).
2. The purpose of these guidelines is to provide guiding principles for the institutions that opt for the use of the WAM approach instead of the final legal maturity approach when calculating the risk-weighted exposure amounts for the specific purpose of determining the capital requirement of a securitisation position.
3. When developing the present guidelines, the EBA considered that the methodology applicable to the determination of the WAM for regulatory purposes should be sufficiently harmonised, while allowing for its usage by less sophisticated institutions using the external ratings-based approach to securitisation (SEC-ERBA); conservative, to maintain a sufficient level of prudence; and simple, to facilitate the supervision by competent authorities.
4. The main areas covered by the draft guidelines are the following:
  - meaning of contractual payments due under the tranche;
  - data and information requirements;
  - methodologies for determining the contractual payments of the securitised exposures due under the tranche for both traditional and synthetic securitisations;
  - implementation and use of the WAM model.
5. Given the different source of cash flows generated within traditional and synthetic securitisations, the guidelines provide two different methodologies for the purpose of calculating the WAM of a tranche:
  - *In the case of traditional securitisation*, the contractual payments due under the tranche should be understood as the combination of (i) the contractual payments of the underlying exposures payable to the securitisation special purpose entity (SSPE) and (ii) the contractual payments payable by the SSPE to the tranche holders. In order to calculate these payments, the guidelines specify how institutions should rely on the asset model to calculate the contractual payments due by the borrowers of the underlying exposures, and which inputs should be considered in the liability model to calculate the contractual payments payable by the SSPE to the tranche holders.

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

<sup>2</sup> Regulation of the European Parliament and the Council No 2401/2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

- *In the case of synthetic securitisations*, the contractual payments due under the tranche should be understood as the sum of (i) the contractual payments of the premia payable by the originator to the protection provider and (ii) the contractual payments received by the originator from the borrowers of the underlying exposures that are allocated to the reduction of the outstanding amount of the tranche, provided that the transaction documentation is clear enough to allow such allocation. Following this interpretation, these guidelines contain provisions on the asset model applicable to the pool of securitised exposures in order to determine the contractual payments to be allocated to the reduction of the outstanding amount of the tranches that is used in the calculation of the premia.
6. These guidelines also provide clarifications regarding the data requirements, in particular with regard to the use of external data and third-party data and model providers. They also set out the expectations concerning the review and the implementation of the WAM model.

# 1. Background and rationale

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## Mandate

7. The new CRR framework for securitisation has introduced tranche maturity ( $M_T$ ) as an additional parameter in the CRR formulae to calculate the risk weights of securitisation positions. Institutions using the internal ratings-based approach (SEC-IRBA) or the SEC-ERBA are now required to include this parameter when calculating the risk-weighted exposure amounts applicable to their securitisation positions.
8. According to Article 257 of the CRR, two alternative approaches may be applied when determining the maturity of a tranche: (i) the WAM of the contractual payments due under the tranche<sup>3</sup> or (ii) the final legal maturity of the tranche<sup>4</sup>. In both cases, the tranche maturity is subject to a floor of 1 year and a cap of 5 years. The choice between the WAM approach and the final legal maturity approach is left to the full discretion of the institutions.
9. Article 257(4) of the CRR mandates the EBA to monitor the range of market practices in this area, with particular regard to the application of Article 257(1)(a) (i.e. the WAM of the contractual payments due under the tranche), and to issue guidelines to specify the rules that institutions should follow when measuring the tranche maturity using the WAM approach.

## Overview of current market practices

10. In order to monitor market practices, the EBA developed a qualitative questionnaire, which included (i) a first part dedicated to the current practices to assess whether and how institutions currently calculate the maturity of their securitisation positions and (ii) a second part dedicated to the implementation of the guidelines, with the purpose of understanding how institutions will choose from the two options when measuring the maturity of securitisation positions.
11. The questionnaire was sent to a number of industry associations and was used as relevant input for the drafting of the present guidelines.

### Use and definition of the WAM

12. Most market participants have already been calculating the WAM of securitisation positions and consider it a key parameter for several purposes such as pricing and trading, return calculation, funding and risk analysis, and hedging in respect of traditional securitisations. For these purposes, WAM is calculated based on conditional cash flow assumptions such as prepayment, delinquency, default and recovery.

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<sup>3</sup> In accordance with the following formula:  $\sum_t t \cdot CF_t / \sum_t CF_t$ , where  $CF_t$  denotes all contractual payments (principal, interests) payable by the borrower during period  $t$ .

<sup>4</sup> In accordance with the following formula:  $M_T = 1 + (M_L - 1) * 80\%$ , where  $M_L$  is the final legal maturity of the tranche.

13. All respondents also regard the WAM of the contractual payment due under the tranche as a combination of both contractual payments of the borrower in relation to the securitised loan agreement and contractual payments payable by the SSPE. They use these two dimensions in their cash flow models to estimate the maturity of the tranche. However, there are some cases where the maturity of the tranche would be determined regardless of the performance of the underlying assets (e.g. exposures to warehouse facilities, exposures to ABCP conduits, 'controlled amortisation' tranches<sup>5</sup>).

#### Asset models (to derive periodical cash flows to the SSPE)

14. The type of data and models (external/internal) used by institutions to calculate the WAM usually depends on the position they have in the securitisation:
- a. When acting as an originator, sponsor or servicer, institutions tend to use internal data and to apply their own cash flow model.
  - b. When acting as investors, institutions tend to use existing industry-standard external models<sup>6</sup> with data from investor reports and data from the European Data Warehouse or, when available, directly provided by the originator or servicer.
15. Institutions also tend to use the same parameters to determine the asset-side cash flows although their consideration might differ. In particular, all respondents take prepayments into account in their cash flow models but there is no standardised market practice regarding the definition of the prepayment rate. On the contrary, it is less common to take into account (i) defaults and delinquencies for maturity calculation, unless the assets are expected to suffer significant losses (e.g. high-risk portfolios, non-performing portfolios) or have already defaulted, and (ii) the economic cycle forecast, as most cash flow models are based on historical data observed through the cycle.

#### Liability models (to derive contractual payments by the SSPE)

16. Similarly to the asset models, most respondents tend to use their own liability models to derive the maturity of the tranche when acting as originator. External data and models are more likely to be used when institutions act as investors, especially when the data have not been provided by the arranger/servicer.
17. The liability model always intends to mirror the key contractual features of the securitisation as described in the transaction documentation. In general, pre- and post-enforcement interest and principal priority of payments as well as performance-based triggers that can alter the priority of payments are implemented in these models for the calculation of WAM.
18. Contractual features such as clean-up calls and other optional redemption such as step-up calls are also often considered in the model. In particular, institutions often model the

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<sup>5</sup> After a period in which only interest payments are made, payments of principal start in a predefined way.

<sup>6</sup> Such models include but are not limited to Bloomberg, Intex, Trepp and Moody's Analytics.

probability that the option is exercised at call date taking into account the economics and the consequences for the reputation of the originator of not exercising the call.

### Implementation of the WAM

19. Most institutions intend to apply the WAM whenever possible, as the final legal maturity is viewed as less risk-sensitive and leading to estimations that are more conservative. The choice between the WAM and the legal maturity will be made taking into account (i) the data availability, (ii) the benefit in terms of risk weights of using the WAM versus the final legal maturity and (iii) the cost of developing the internal model or using an external model (depending on the complexity of the rules and parameters).
20. Although institutions acknowledge that the differences between the two approaches might be reduced considerably in certain cases after applying the regulatory cap of 5 years and the floor of 1 year, they consider that in other cases using the WAM or the final legal maturity can produce significantly different results depending on (i) the maturity of assets (differences tend to be higher for medium-term underlying assets), (ii) the amortisation structure (pass-through or scheduled) and (iii) the jurisdiction (due to differences in the legal period of enforcement and recovery).
21. Institutions would like to implement the WAM for all their securitisation exposures. However, they also note that the WAM might be challenging to implement on revolving loans and for securitisation exposures for which the underlying structure and credit enhancement is based on the proceeds from the liquidation of the assets and not from the contractual payments (e.g. car rental, retail floor planning).

### Rationale of the guidelines

22. The purpose of these guidelines is to provide fundamental guiding principles on the WAM approach to be followed by institutions opting for the use of the WAM approach instead of the final legal maturity approach, for the specific purpose of calculating the capital requirements of a securitisation position under the SEC-IRBA or the SEC-ERBA. As a result, while current market practices have constituted a major starting point for the drafting of these guidelines, some deviations from such market practices are proposed to ensure that the calculation of the regulatory WAM is comparable across EU institutions and is made in a sufficiently prudent manner.
23. In particular, the present guidelines have been developed with the following objectives in mind:
  - a. Ensure comparability and simplicity of the WAM approach. Institutions currently calculate the WAM of a tranche in very heterogeneous ways and for various purposes. The main objective of these guidelines is to ensure that the methodology applicable to the determination of the WAM for regulatory purposes is sufficiently harmonised to increase consistency and comparability in the capital held by institutions. This methodology should also be clear, conservative and simple, to avoid arbitrage, to



maintain a sufficient level of prudence and to facilitate its supervision by competent authorities.

- b. Ensure usability of the WAM approach. The present guidelines were also developed with the view that the use of the WAM approach should remain possible for all eligible institutions. These include institutions acting as investors that might not have sufficient and direct access to data on the securitised exposures, and less sophisticated institutions using the SEC-ERBA approach. As a result, the guidelines pay particular attention to the extent to which external data and third-party providers of data and models could be allowed for the calculation of the regulatory WAM.
- c. Ensure reliability and predictability of the WAM approach. Although institutions often use the same parameters to calculate the WAM for tranches of traditional securitisations, their calibration might differ significantly especially with regard to the treatment of prepayment assumptions, default scenarios and optional redemption mechanisms of the notes. As a result, the guidelines are proposing a prudent approach for the calculation of the regulatory WAM whereby only predictable and reliable parameters should be used in the WAM model.

## Scope and general content of the guidelines

24. Given the different sources of cash flows generated within traditional and synthetic securitisations, these guidelines provide two different methodologies for the purpose of calculating the WAM of a tranche for traditional and synthetic securitisations.

- In the case of traditional securitisations, the contractual payments due under the tranche should be understood as the combination of (i) the contractual payments of the underlying exposures payable to the SSPE and (ii) the contractual payments payable by the SSPE to the tranche holders.

In order to calculate these payments, the guidelines specify how institutions should rely on the asset model to calculate the contractual payments due by the borrowers of the underlying exposures, and which inputs should be considered in the liability model to calculate the contractual payments payable by the SSPE to the tranche holders.

- In the case of synthetic securitisations, for both the originator and the protection provider calculating the WAM, the contractual payments due under the tranche should be understood as (i) the contractual payments received by the originator from the borrowers of the underlying exposures that are allocated to the reduction of the outstanding amount of the tranche (provided that the transaction documentation is sufficiently clear to allow this allocation) and (ii) the contractual payments of the premia payable by the originator to the protection provider.

Following this interpretation, these guidelines contain provisions on the asset model applicable to the pool of securitised exposures in order to determine the contractual payments from the borrowers to be allocated to the reduction of the outstanding amount of

the tranches and the corresponding size of the protected tranches throughout the life of the protection, which is the basis for the calculation of those premia that are contingent on that size.

For the protected tranches, institutions should compute the cash flows coming both from the payments of premia and from the allocation of the payments of the borrowers to the amortisation of the tranche, while for the rest of the tranches they should only compute the latter.

25. **Treatment of prepayments.** Prepayments are contractual features that are very commonly taken into account in the market in the calculation of the maturity of the tranche. This parameter can have a significant impact on the maturity of the tranches (i.e. by increasing the proceeds to amortise the tranches towards the first years of the transaction). According to the data, prepayment behaviour varies significantly depending on the asset type of the underlying assets and the jurisdictions. Therefore, in the case of traditional securitisations, these guidelines take into account prepayments, under strict conditions, in order not to discriminate against those asset classes and jurisdictions that show higher prepayment rates. However, adopting a more conservative approach, prepayments are not taken into consideration in the case of synthetic securitisations due to their distinct characteristics, in terms of securitised exposures that are more tailor-made than those of traditional securitisations, which would make the conditions reflected in these guidelines to take into account prepayments less reliable.
26. **Treatment of optional features.** Optional features other than clean-up calls are not allowed for the purpose of the calculation of the WAM, with the exception of those in synthetic securitisations where the originator has an option to terminate the protection and where there is a positive incentive to call the transaction before the contractual maturity. Options that investors may have to terminate the protection early are not taken into account in these guidelines in order not to encourage institutions to provide protection to other institutions due to the possibility of shortening the maturity of their securitisation position. This treatment is due to Article 252 of the CRR, which sets out an adjustment in the event of a maturity mismatch between the credit protection and the securitised portfolio in synthetic securitisations for the originator only. In such a case, originators are expected to apply these guidelines consistently with Article 252 of the CRR. In particular, if the originator's options are taken into account to shorten the length of the protection when calculating the WAM and the risk weight of the securitisation position, the same length should be taken into account when calculating the maturity mismatch between the protection and the securitised portfolio. An adjustment in the risk weight of the securitisation position should be made then in accordance with Article 252 of the CRR. Originators should also be aware that certain options to terminate the protection may be considered a reason to object the recognition of significant risk transfer, independently of how they are treated in these guidelines.
27. With regard to the **use of data**, when the institution calculating the WAM is the servicer of the securitised exposures it should rely on internal data, as it has full access to the information needed to calculate the WAM, which is a subset of the information it needs to service these exposures. When the institution calculating WAM is not the servicer of the securitised

exposures, it has to resort to external data, which in most cases will be available in the transparency templates set out in the Securitisation Regulation<sup>7</sup>.

28. With regard to the **use of the model**, it should be noted that, in contrast to the requirements for rating systems and internal models approaches to equity used for IRB purposes, the CRR does not include a requirement in terms of a specific prior approval by competent authorities for the use of WAM approach in the calculation of own funds requirements for securitisation positions under the SEC-IRBA (as specified in Article 259 of the CRR) or under SEC-ERBA (as specified in Article 263 of the CRR).

29. The guidelines are structured as follows:

- Section 4.1: contractual payments under point (a) of Article 257(1) of Regulation (EU) No 575/2013;
- Section 4.2: data and information;
- Section 4.3: asset model: methodology for determining the contractual payment due to the SSPE;
- Section 4.4: liability model: methodology for determining the contractual payments payable by the SSPE to the tranche holders for traditional securitisation;
- Section 4.5: methodology for determining the contractual payments due under the tranche in case of synthetic securitisations;
- Section 4.6: monitoring and implementation of the WAM approach.

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<sup>7</sup> Regulation (EU) 2017/2402 laying down a framework for securitisation and creating a specific framework for STS securitisation.

## 2. Guidelines on the determination of the weighted average maturity of the tranche

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Guidelines on the determination of the weighted average maturity of the tranche in accordance with point (a) of Article 257(1) of Regulation (EU) No 575/2013

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# 1. Compliance and reporting obligations

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## Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010<sup>8</sup>. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by 30.08.2020. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu) with the reference 'EBA/GL/2020/04. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to the EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

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<sup>8</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

## 2. Subject matter, scope and definitions

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### Subject matter

5. These guidelines specify the methodology for measuring the maturity of a tranche (MT) as the weighted average maturity (WAM) of the contractual payments due under the tranche ( $CF_t$ ) referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013<sup>9</sup>. For that purpose, these guidelines set out how to determine contractual payments referred to in that article. They also specify the data necessary to apply the WAM approach and its monitoring and implementation.

### Scope of application

6. These guidelines fulfil the EBA's mandate to issue guidelines in accordance with Article 257(4) of Regulation (EU) No 575/2013.
7. These guidelines apply to institutions measuring the tranche maturity in accordance with point (a) of Article 257(1) of Regulation (EU) No 575/2013.

### Addressees

8. These guidelines are addressed to competent authorities as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation (EU) No 1093/2010.

### Definitions

9. Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013 and in Regulation (EU) 2017/2402<sup>10</sup> have the same meaning in the guidelines.

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<sup>9</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (OJ L 176, 27.6.2013, p. 1).

<sup>10</sup> Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (OJ L 347, 28.12.2017, p. 35).

## 3. Implementation

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10. These guidelines apply from 1 September 2020.



## 4. Guidelines

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### 4.1 Contractual payments under point (a) of Article 257(1) of Regulation (EU) No 575/2013

#### 4.1.1 Traditional securitisations

11. In the case of traditional securitisations, institutions should determine the contractual payments as referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013 on the basis of the contractual payments payable by the originator to the SSPE and those payable by the SSPE to the tranche holders. For that purpose, institutions should apply the following steps in sequence:

(a) institutions should determine the contractual payments of the borrowers of the underlying exposures payable to the SSPE in application of the asset model as set out in Section 4.3;

(b) institutions should feed the output of the application of the asset model into the calculation of the contractual payments payable by the SSPE to the tranche holders in accordance with the priority of payments established in the transaction documentation in application of the liability model by applying the following steps in sequence:

(i) they should determine the total amount of cash flow payable by the SSPE as set out in Section 4.4.2;

(ii) they should allocate the contractual payments to the tranche holders as set out in Section 4.4.3.

12. The outcome under point (b) above should be considered the contractual payments for the purposes of point (a) of Article 257(1) of Regulation (EU) No 575/2013.

#### 4.1.2 Synthetic securitisations

13. In the case of synthetic securitisations, institutions should determine the contractual payments as referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013 as follows:

(a) Where tranches are subject to credit protection, the contractual payments referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013 should be considered to be the sum of:

(i) the contractual payments payable to the originator by the borrowers of the underlying exposures, which are allocated to the reduction of the outstanding amount of the tranche, and

- (ii) the contractual payments of the premia payable by the originator to the protection provider of the protected tranche as set out in Section 4.5.
- (b) For tranches other than those referred to in point (a) above, the contractual payments referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013 should be considered to be only the contractual payments payable to the originator by the borrowers of the underlying exposures, which are allocated to the reduction of the outstanding amount of the tranche.

## 4.2 Data and information

### 4.2.1 Source of data on the underlying pool of exposures

#### Use of internal data

- 14. For the purposes of the application of the WAM approach as referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013, institutions should use internal data on the underlying portfolio of the securitised exposures, where they are the servicer of the securitised exposures.

#### Use of external data

- 15. Where institutions are not the servicer of the securitised exposures and does not have access to internal data, they should only use the following sources of external data:
  - (a) data provided by the originator, sponsor, SSPE or servicer, either directly or transmitted through a third-party data provider,
  - (b) data on the underlying exposures of the securitisation made available by the originator, sponsor and SSPE in accordance with points (a) and (e) of Article 7(1) of Regulation (EU) 2017/2402,
  - (c) data on the underlying exposures of the securitisation as required by Article 5 of Regulation (EU) 2017/2402,
  - (d) the transaction documentation.

### 4.2.2 Data on the underlying pool of exposures

- 16. For the purposes of the application of the WAM approach as referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013, the data necessary to apply the asset model set out in Section 4.3 should be complete.
- 17. Where the data necessary to apply the asset model are incomplete, institutions should make the necessary adjustments as set out in this section. Where the lack of data concerns the current principal balance or the currency denomination of the underlying exposures, the institution should not use the WAM approach referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013.

18. The adjustments referred to in paragraph 17 should reflect the most conservative assumption, which should be the one that postpones the contractual payments closest to the final legal maturity of the transaction. For that purpose, institutions should first use the information available in the transaction documentation on the eligibility criteria, and afterwards apply the following non-exhaustive list of adjustments depending on which information on the underlying exposure is incomplete.

Where information on the underlying exposures is incomplete with regard to:

- (a) the 'maturity date', institutions should apply the final legal maturity;
  - (b) the 'amortisation type', institutions should apply bullet amortisation, meaning the amortisation in which the full principal amount is repaid in the last instalment;
  - (c) the 'scheduled principal payment frequency', institutions should apply an annual frequency where the amortisation type requires periodical instalments;
  - (d) the 'scheduled interest payment frequency', institutions should apply an annual frequency where the amortisation type requires periodical instalments;
  - (e) the 'current interest rate', where there is information on the interest rate range of the securitised exposures in the transaction documentation, institutions should apply the lowest interest rate possible.
19. By way of derogation from paragraph 18 point (e), where the outstanding amount of exposures in relation to which the information on the current interest rate is not available does not exceed 5% of the total outstanding amount of the securitised exposures, institutions should apply to those exposures the exposure-weighted average interest rate of the securitised exposures for which that information is available.

#### **4.2.3 Information on the securitisation transaction**

20. For the purposes of the application of the WAM approach as referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013, institutions should rely on accurate and reliable sources of information.
21. The documentation of the transaction should be the primary source of information to calculate the contractual payments due from the SSPE to the holders of a securitisation position in a traditional securitisation, and to calculate the contractual payments derived from the protection agreement between the protection buyer and the protection provider in a synthetic securitisation.
22. Institutions should predominantly use the information made available in accordance with Article 7 of Regulation (EU) 2017/2402.
23. In the case of non-ABCP STS securitisations, institutions may also use the liability cash flow model made available in accordance with Article 22(3) of Regulation (EU) 2017/2402 as additional information.

24. Where the originator, sponsor and SSPE are established in a third country, information made available on the documentation of the securitisation as required by Article 5 of Regulation (EU) 2017/2402 should also be taken into account.

## 4.3 Asset model: methodology for determining the contractual payments due to the SSPE

### 4.3.1 General provisions for asset models

25. With the asset model, institutions should determine all contractual payments payable to the SSPE generated by the portfolio during period  $t$  as referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013.
26. Institutions should use as key parameters all relevant information that may affect those payments, including the principal, interest and, as applicable, fees.
27. Institutions should determine payments on a loan-by-loan basis. Where appropriate due to granularity, the forecast may be modelled on the basis of homogeneous sub-pools of the securitised exposures for asset types such as trade receivables.
28. The cash flows coming from non-performing exposures should be modelled separately from those of performing exposures.

### 4.3.2 Methodology for performing underlying exposures

#### Payments of principal and interest

29. Principal payments should be calculated at loan level taking into account terms and conditions agreed between the borrower and the originator or the original lender, which influence the amount and frequency of the payments. In particular, the calculation should accurately reflect the contractual frequency of the payments, the expected amount of principal repayment and the related interest charges that should be collected for each period.
30. Institutions should assume that the amortisation method and the interest rates applicable on the calculation date of the WAM remain constant throughout the life of the loan where the contract sets out options not yet realised or triggered. Where the contract already envisages that the amortisation method and/or interest rates applicable in future periods change in a completely predetermined manner, so that the exact value of the amortisation and/or interest rate applicable in a future period can already be determined at the calculation date of the WAM, institutions should take those future changes into account.

#### Treatment of revolving periods

31. For the purposes of applying the asset model to revolving securitisations, institutions should apply all of the following steps:

- (a) Institutions should determine the scheduled maturity of each securitised exposure as of the calculation date of the WAM.
- (b) For each securitised exposure maturing before the end of the replenishment or the revolving period, institutions should adjust the scheduled maturity to equal the sum of its current maturity and the longest permitted maturity of an exposure that it is eligible to be added to the securitised portfolio during the replenishment or revolving period. The adjustments should be made as many times as necessary for that purpose when the term of the adjusted maturity is shorter than the term of the replenishment or the revolving period.
- (c) The final maturity should not be adjusted when the securitised exposure is scheduled to mature after the end of the revolving period.

### Assumptions in relation to prepayments

32. Institutions may take into account prepayments, where there is sufficient data on the historical prepayment rate of the asset class observed over the last 5 years in the country in which the assets were originated, on condition that they take into account the lowest of:
- (a) the prepayment rate considered in the base case scenario of the pricing prepayment assumptions of the transaction, with a 20% cap;
  - (b) the lowest historical prepayment rate of the asset class observed quarterly, or at least annually, over the longest available period, with a minimum of 5 years, in the country in which the assets were originated;
  - (c) the average observed quarterly prepayment rate throughout the life of the transaction since its inception, with a minimum of 1 year's data.

### Assumptions in relation to future defaults

33. Where the exposures are part of a performing portfolio, institutions should assume zero future defaults and delinquencies at the time of the WAM calculation.

### Cash account and other investments

34. Institutions should not take into account the income coming from the deposit account and other short-term investments made by the SSPE.

### Contractual agreements on the securitised exposures

35. Institutions should take into account contractual agreements entered into by the issuer and designed to mitigate the risk of the securitised exposures.
36. At each calculation date of the WAM, institutions should assume that the payments between the parties of the contract remain constant at the level that they have at the calculation date, for the remaining life of the contract, even if the contract foresees optionalities not yet realised

or triggered. Where the contract already envisages that the payments applicable in future periods change in a completely predetermined manner so that the exact value of the payment applicable can already be determined at the calculation date of the WAM, institutions should take those future changes into account.

37. Where the payments between the parties of the contract are linked to outstanding notional values, which can be calculated in accordance with the provisions of the asset model set out in this section, future payments should be adjusted to reflect the expected development of those notional values.

#### Contractually agreed triggers on the securitised exposures

38. Where the trigger event has occurred, institutions should take into account contractually agreed triggers that changed the cash flow of the securitised exposures from the activation date. Where contractually agreed triggers will be applicable on a certain future date in a completely predetermined manner so that the exact change of the future cash flow can be determined at the WAM calculation date, institutions should take also those future triggers into account.

#### 4.3.3 Methodology for non-performing exposures

39. The principal and interest payments of exposures not performing at the time of the calculation of the WAM should be assumed to be equal to zero throughout the life of the securitisation.

#### Recovery rate assumptions

40. Where institutions are allowed to use own LGD estimates in accordance with the requirements of Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013 for part of the securitised exposures, they should use the value of 1 minus the LGD as the recovery rate for these securitised exposures.
41. Institutions should use the value of 1 minus the average historical loss rate observed during the last 5 years for the asset class in the country in which the assets were originated as the recovery rate for the securitised exposures other than those referred to in paragraph 40. Where the information on the full 5 years is not available, the highest historical loss rate observed should be used. Where none of this information is available from reliable sources, such as mortgage associations in cases of mortgage loans or credit-rating agencies with long data records, institutions should use a 50% loss rate for senior non-retail securitised exposures and for retail securitised exposures and a 100% loss rate for non-senior non-retail securitised exposures.

#### Recovery-timing assumptions

42. Where institutions are allowed to use own LGD estimates in accordance with the requirements of Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013, they should use as recovery timing the average workout period assumptions used in their LGD in default models. For the remaining institutions, the recovery timing should be assumed to be the average historical

workout period observed in the last 5 years in the same asset class and country, in which the assets were originated. Where that information is not available, the longest historical observed workout period should be used instead. Where none of this information is available from reliable sources (e.g. national mortgage associations in cases of mortgage loans or credit-rating agencies with long data records), institutions should assume that all the recoveries will take place at the final legal maturity of the transaction.

## 4.4 Liability model: methodology for determining the contractual payments payable by the SSPE to the tranche holders for traditional securitisation

### 4.4.1 General provisions on the liability model

43. All the input variables used in the liability model should accurately take into account the contractual terms and conditions of the transaction set out in the securitisation transaction documentation, including but not limited to:
  - (a) all relevant information on the tranches such as the final legal maturity, the payment frequency, the coupon rate, the interests, principal and notional amounts of the tranches;
  - (b) the key structural features such as the priority of payments and related triggers;
  - (c) hedging arrangements, structural protection mechanisms, costs and fees.
44. Optional contractual features, except clean-up calls as referred to in point (g) of Article 244(4) of Regulation (EU) No 575/2013, that would reduce the maturity of the tranche should not be considered.

### 4.4.2 Determination of the total amount payable by the SSPE

#### General principles for determining the total cash flow amount

45. Institutions should calculate the total cash flow amount payable by the SSPE at each payment date. Institutions should use the outcome produced in application of the asset model as set out in Section 4.3 and adjust it to account for any cash flows coming from the hedging arrangements and structural protection mechanisms, where applicable, and the fees and costs to be incurred by the SSPE before allocating the contractual payments to the tranches as specified in this section.

#### Adjustments

46. Hedging arrangements entered into by the SSPE to cover for payment mismatches between the cash flows generated by the underlying exposures and the cash flows payable to the tranche holders should be taken into account in the calculation of the total available cash flow amount payable by the SSPE. These adjustments should include the outflows and inflows coming from currency and interest rate swaps, where applicable.

47. Institutions should also include the actual cash flows deriving from the use of structural protection mechanisms aimed at ensuring that the principal and interest payable under the tranches are paid in full and on time, where applicable, such as the outflows or inflows resulting from a liquidity facility, a reserve fund or an excess spread-trapping mechanism.
48. Institutions should include adjustments referred to in paragraphs 46 and 47 only:
  - (a) where a hedging arrangement or a structural protection mechanism has been used and has an impact on the total payable amount, in which case institutions should rely on actual observed data as applicable at the date of calculation of the WAM;
  - (b) where they will be applicable on a certain future date in a completely predetermined manner so that the exact change of the cash flow in a future period can already be determined at the respective WAM calculation date.

#### **4.4.3 Allocation of the contractual payments among the tranche holders**

49. The allocation of payments among tranche holders should appropriately reflect the terms of the contractual agreement of the securitisation transaction as applicable at the date of calculation of the WAM.

#### **Treatment of structural features**

50. All structural features of the transaction that govern the allocation of payment among the tranche holders should be taken into account when modelling the liability cash flows. These should include, in particular, the contractual rules regarding the priority of payments, the amortisation profile of the notes and any changes following the use of a trigger.

#### **Priority of payment**

51. The allocation of payments to each tranche holder should follow the contractual rules regarding the priority of payment, which should accurately specify the order in which the notes of each tranche are paid and the timing under which the payments are allocated.
52. In addition, where applicable, the prevailing rules regarding the replenishment of the liquidity facility after a partial or full draw-down, the amortisation of the reserve fund and the replenishment of the principal deficiency ledger should be taken into account when determining the payment of each note.

#### **Amortisation profile**

53. The amortisation of the notes of a tranche should be factored into the liability model. The liability model should accurately replicate the amortisation rules applicable to each note as defined in the priority of payments according to the transaction documentation at the time of the calculation of the WAM.

#### **Triggers**



54. The contractual triggers modifying the cash flows of the transaction should be considered in the liability model only when they have been activated at the date of calculation of the WAM.
55. Triggers based on the performance of the underlying assets, such as delinquency and loss rates, or on the prepayment speed of the underlying assets should not be assumed active unless the actual performance at the date of calculation meet the predetermined conditions. However, where a contractually agreed trigger will be applicable on a certain future date in a completely predetermined manner so that the exact change of the cash flow in a future period can already be determined at the calculation date of the WAM, institutions should take those future changes into account.

### Treatment of optional features

56. Optional contractual features, such as step-up calls, put options, regulatory calls, time calls and tax calls that would reduce the maturity of the note should not be considered.
57. By way of derogation from the previous paragraph, clean-up calls in accordance with point (g) of Article 244(4) of Regulation (EU) No 575/2013 that permit early redemption of the notes before the securitised exposures are fully amortised may be taken into account.

## 4.5 Methodology for determining the contractual payments due under the tranche in case of synthetic securitisations

### 4.5.1 General principles for determining the cash flow amount

58. Institutions should determine the contractual payments payable to the originator by the borrowers of the underlying exposures by applying the same methodology as for the performing exposures in traditional securitisations as set out in Section 4.3. The contractual payments should be those that are to be allocated to tranches in accordance with the terms and conditions of the transaction. Prepayments should be excluded.
59. Institutions should allocate the contractual payments referred to in paragraph 58 to the tranches by reducing their outstanding amounts, in accordance with the allocation set out in the terms and conditions of the transaction. The terms and conditions should accurately reflect this allocation at the time of the calculation of the WAM. Where the allocation is not clearly set out in the terms and conditions, institutions should not apply the WAM approach set out in point (a) of Article 257(1) of Regulation (EU) No 575/2013.
60. Institutions should determine the contractual payments of the premia to be paid by the originator in accordance with the contractual terms and conditions of the transaction as defined in the securitisation transaction documentation.
61. Where the contractual payments of the premia are contingent on the outstanding balance of the tranches that are associated with the credit protection, institutions should model the outstanding balance of the tranche for the coming periods until the final legal maturity of the transaction, in accordance with this section.

#### 4.5.2 Amortisation

62. Institutions should take into account the amortisation system set out in the transaction documentation in order to determine the outstanding amount of the tranches and should assume that the amortisation system of the tranches at the date of calculation of the WAM is applicable throughout the life of the transaction.
63. Where the transaction documentation already envisages that the amortisation system applicable in future periods changes in a completely predetermined manner so that the exact future value of the amortisation can be determined at the calculation date of the WAM, institutions should take those future changes into account.

#### 4.5.3 Triggers

64. Where the guarantee or the contract includes a trigger that changes the amortisation system from one system to another (e.g. from pro rata to sequential) based on certain conditions to be met (e.g. the performance of the securitised exposures), this trigger should not be considered unless it has already been activated at the date of calculation of the WAM. However, where a trigger will be applicable on a certain future date in a completely predetermined manner so that the exact change of the cash flow in a future period can already be determined at the respective WAM calculation date, institutions should take that trigger into account.

#### 4.5.4 Optional features

65. Where the originator has an option to terminate the protection, and the terms and conditions of the transaction contain a positive incentive for the originator to call the transaction before contractual maturity, the originator should consider the maturity of the protection to be the time of the earliest date at which that option may be exercised; otherwise the originator should treat such an option as not affecting the maturity of the protection.
66. Institutions may take into account clean-up calls that are compliant with point (f) of Article 245(4) of Regulation (EU) No 575/2013 that permit early redemption of the notes before the securitised exposures are fully amortised.

### 4.6 Monitoring and implementation of the WAM approach

#### 4.6.1 Model adjustments

67. The models used for the application of the WAM approach should be monitored and updated whenever necessary to account for:
  - (a) any variations of the key parameters including the outstanding note balance, the status of the triggers and the performance of the transaction; and
  - (b) any other material changes to the transaction including the restructuring of the notes or of the underlying exposures.

#### **4.6.2 Use of third-party data providers**

68. Institutions should rely on third-party data providers only where they have carried out appropriate due diligence to ensure the conformity of the third party with these guidelines. For that purpose, institutions may take into account the assessment by an external independent auditor who has a demonstrable expertise in cash flow modelling and has a thorough understanding of securitisation.

#### **4.6.3 Third-party models**

69. Institutions should rely on third-party model providers only where they have carried out appropriate due diligence and have confirmed that the third party complies with the guidelines and has an appropriate level of market expertise in cash flow modelling and a thorough understanding of securitisation. For that purpose, institutions may take into account the assessment by an external independent auditor who has a demonstrable expertise in cash flow modelling and a thorough understanding of securitisation.

#### **4.6.4 In house models**

70. The asset and liability models developed by the institutions for calculating the WAM should be subject to an initial review, which may be either an independent internal review or an external review by an independent auditor. In order for an internal review to be independent, the assessment should be conducted by staff independent from the staff responsible for the model design or development. Both internal and external auditors should have a demonstrable expertise in cash flow modelling and a thorough understanding of securitisation.

#### **4.6.5 Quality review**

71. Institutions and third-party model providers should have the expertise and capacity to maintain a cash flow model that accurately reflects the prevailing characteristics of the underlying portfolio and of the transaction at the date of calculation of the WAM.
72. The consistency and reliability of the asset and liability model should be reviewed annually on a sample basis by the staff of the institution who are not responsible for their model design or development, in the case of in-house models, or for the internal audit. The independent review should at least assess:
- (a) the quality of the process to gather the input data used in the asset model and the representativeness of the input data;
  - (b) the accuracy of the process to gather the key parameters with regard to the terms and conditions of the transaction documentation;
  - (c) the correctness of the overall calculation.
73. The independent review should provide the institution with documentation specifying whether it agrees that the asset and liability models produced valid results and stating, where

relevant, recommendations on adjustments that could improve the quality of the asset and liability models.

#### **4.6.6 Implementation by institutions**

74. Institutions should apply the WAM approach referred to in point (a) of Article 257(1) of Regulation (EU) No 575/2013 in a consistent way across all the securitisation positions that belong to the same securitisation transaction.
75. Where the WAM approach is used to determine the own funds requirements for securitisation positions in accordance with the SEC-IRBA or SEC-ERBA, the WAM of each securitisation position as determined for the respective tranche should be calculated and updated at least on a quarterly basis.
76. Where institutions determine the maturity of a securitisation position using the WAM approach in point (a) of Article 257(1) of Regulation (EU) No 575/2013, they should apply the WAM approach consistently and in accordance with Article 257(2) of that regulation until the institution ceases to hold that securitisation position. Exceptionally, where the final legal maturity falls below 1 year, institutions should be allowed to stop using the WAM approach.

## 5. Accompanying documents

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### 5.1 Cost-benefit analysis/impact assessment

1. As per Article 16(2) of the EBA Regulation (Regulation (EU) No 1093/2010), guidelines developed by the EBA shall be, where appropriate, accompanied by an impact assessment which analyses the related potential related costs and benefits. This section provides an overview of such impact assessment, and the potential costs and benefits associated with the implementation of the guideline

#### 5.1.1 Problem identification

2. The guidelines have been developed in accordance with the mandate assigned to the EBA in Article 257(4) of the CRR, which requests the EBA to monitor the range of practices in the determination of the maturity of a tranche of a securitisation transaction, with particular regard to the application of point (a) of paragraph 1 of Article 257, and, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines by 31 December 2019.
3. One of the major shortcomings of the Basel II securitisation framework, and of the CRR before the 2017 amendment, was the sharp cliff effects in marginal capital charges. The Basel Committee considered that this was driven in part by the lack of an adequate incorporation of maturity, as the Basel II securitisation framework looked only at the risk of default over a 1-year horizon, ignoring the risk of a potential deterioration afterwards, implicitly assuming that a given tranche will not incur any market value loss until the values for all more junior tranches have been reduced to zero.
4. On the understanding that the use of the final legal maturity is overly conservative and does not reflect the real maturity of the tranche, the Basel Committee agreed to apply a haircut in order to smooth the impact of tranche maturity on capital charges when final legal maturity is used. This has also been considered in Article 257(1)(b) of the CRR as amended. Nevertheless, in order to provide a more precise measurement of tranche maturity, Article 257(1)(a) of the CRR as amended sets out the option for institutions to calculate tranche maturity as the WAM of the contractual payments due under the tranche.

#### 5.1.2 Policy objectives

5. The main objectives of these guidelines is to ensure that the methodology applicable for the determination of the WAM for regulatory purposes is sufficiently harmonised to increase consistency and comparability in the own funds held by institutions. This methodology should also be clear, to avoid arbitrage and allow its usage by less sophisticated institutions using SEC-

ERBA; conservative, to maintain a sufficient level of prudence; and simple, to facilitate the supervision by competent authorities.

### **5.1.3 Assessment of the options adopted**

6. In the case of traditional securitisations, the EBA has addressed the legal mandate by interpreting the wording of Article 257(1)(a) in a way that makes the WAM approach applicable in practice. In the case of traditional securitisations, the EBA understands that the contractual payments due under the tranche mean the combination of (i) the contractual payments of the borrowers in relation to the underlying exposures payable to the SSPE and (ii) the contractual payments payable by the SSPE to the tranche holders. A more restrictive interpretation, considering the second leg only (i.e. the contractual payments payable by the SSPE to the tranche holders), would have limited the application of the WAM approach to those tranches with fixed contractual payments only, which are not the most common tranches in a securitisation, as in most cases the payments that the tranche holders receive depend in one way or another on the performance of the securitised exposures.
7. In the case of synthetic securitisations, the EBA believes that the wording of Article 257(1)(a) gives no room to adopt the current market practice of considering the weighted average life of the securitised exposures as the maturity of the tranche. In consequence, the EBA has addressed the legal mandate by following strictly the wording of Article 257(1)(a) and considers that the contractual payments due under the tranche mean the contractual payments of premia payable to the protection providers by the originator buying protection for a tranche and the contractual payments received by the originator from the borrowers of the underlying exposures that are allocated to the reduction of the outstanding amount of the tranche.

### **5.1.4 Cost-benefit analysis**

8. It is expected that the implementation of these guidelines will improve the risk sensitiveness of the securitisation framework for credit risk in Part Three, Title II, Chapter 5 of the CRR, as one of the main risk drivers will be measured in a more precise way. This will bring about benefits for originators, investors and sponsors in cases of tranches for which the maturity cap of 5 years or the floor of 1 year is not binding by reducing, in most cases, the capital requirements of the tranches held by them, and consequently will incentivise the transfer of risk via securitisation and contribute to a broader and deeper securitisation market in the EU, one of the main objectives of the European Commission's Capital Market Union initiative. This is likely to more than offset the additional costs connected with the development of the asset and liability models set out in these guidelines and the internal governance requirements imposed consequently.

### **5.1.5 Impact assessment**

9. The EBA has conducted an impact assessment in two ways. In the case of traditional securitisations, it analysed the available information for EU banks in the C14 template on securitisation details of the ITS on supervisory reporting as of 31 December 2018. In the case of

synthetic securitisations, because the interpretation of the WAM approach adopted differs from current market practices the C14 template was not useful, so it analysed the impact for a set of stylised transactions.

10. The final legal maturity and the first foreseeable termination date of the transaction (FFTD) are reported in the C14 template. Considering the FFTD as a proxy of the WAM of a tranche in the presence of **pro rata amortisation**, the analysis shows that, for the traditional transactions for which the FFTD is available, the FFTD was below the final legal maturity in 35% of the cases only, and only in such cases is the WAM of benefit to institutions. However, it is reasonable to think that in the case of the most senior tranches of transactions subject to a **sequential amortisation** the number of cases where the WAM is below the final legal maturity would be significantly higher.
11. The use of the WAM approach on risk weights in traditional securitisations has different impacts depending on the approach used for its calculation. In the case of SEC-IRBA, the analysis shows the following:
  - For transactions with a high  $K_{IRB}$  (e.g. NPL securitisations) there is no difference whether the WAM or the final legal maturity is applied. This is because the tranche maturity is only one of the inputs of the  $P$  factor formula, and high levels of  $K_{IRB}$ , which has a negative influence in the formula, leads the  $P$  factor to the floor of 0.3 no matter the tranche maturity value.
  - In cases of performing securitised portfolios, there is no relevant impact on certain senior and mezzanine tranches because the risk weight floor applies irrespective of whether the final legal maturity or the WAM are used. However, assuming a **pro rata amortisation** of all the tranches of the transactions for which the FFTD was below the final legal maturity, risk weights when applying the WAM approach would be around 20% less in relative terms than if applying the final legal maturity, which would be higher for the most senior ones in the presence of **sequential amortisation**.
12. Nevertheless, in the case of SEC-ERBA, the impact on risk weights of the use of the WAM is expected to be especially significant. This is because, in order to determine the risk weights for tranches with maturities between 1 and 5 years, institutions must use linear interpolation between the risk weights for 1 and 5 years, so that any reduction in tranche maturity in this range will reduce the risk weights of the tranches. This linear interpolation gives full credit in all cases, except for STS tranches of credit quality step 1, in terms of reduction in risk weights, when the WAM is lower than the final legal maturity as adjusted in accordance with Article 257(1)(b). However, the higher the difference in risk weights between the columns for 1 year and 5 years in the SEC-ERBA look-up table, the higher the impact of the use of the WAM approach in absolute terms.
13. In the case of synthetic securitisations based on an analysis of stylised transactions with final legal maturity of the protection contracts below 5 years, the WAMs of the tranches tend to be slightly below the WAL of the securitised portfolio, which in turn is below the final legal maturity

of the transaction, when the amortisation of the tranches is on a pro rata basis. However, in the presence of sequential amortisation of the tranches, WAM tend to be higher than WAL but below the final legal maturity of the transaction. The main difference from the analysis made on traditional securitisations above is that the impact, in terms of reduction of risk weights, is higher for senior tranches when the amortisation is on a pro rata basis because the effect of higher premia to be paid increases WAM in sequential amortisation.

14.As regard the impact of prepayments in the context of traditional securitisations, they may reduce significantly the WAM of the senior tranche under a sequential amortisation system of the tranches. However, as explained above, there is no relevant impact on certain senior and mezzanine tranches because the risk weight floor applies irrespective of whether the final legal maturity or the WAM is used. For the rest of the tranches, the impact on WAM would be more relevant under a pro rata amortisation system, and the impact on the risk weights of mezzanine tranches would be more relevant as well, due to the higher sensitivity of capital charges to the maturity of the tranche for tranches with attachment and detachment points in the middle part of the scale.



## 5.2 Feedback on the public consultation

15. The EBA publicly consulted on the draft proposal for the guidelines.
16. The consultation period lasted for 3 months and ended on 31 October 2019. In total, 13 responses were received, mostly from market associations.
17. This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.
18. In some cases, some stakeholders made similar comments, or the same comment was repeated for different questions. In such cases, the comments were included in that section of the paper that the EBA considers most appropriate.
19. Changes to the draft guidelines have been made to account for some of the comments received during the public consultation.

### Summary of key issues and the EBA's response

20. **Methodology for traditional securitisation:** There is a general agreement on the suggested WAM methodology for traditional securitisation. In particular, market participants' view is that the contractual payment due under the tranche should be understood as a combination of contractual payments of the underlying exposures payable to the SSPE and the contractual payments of the SSPE to the tranche holders.
21. **Methodology for synthetic securitisation:** Most respondents disagree with different treatments for funded and unfunded credit protection. They consider that an unbalanced treatment would imply an economic incentive for the originator to use unfunded protection in preference to funded protection although the latter is less risky.
22. **Treatment of prepayment:** Most respondents do favour the inclusion of prepayment from the calculation of the WAM. They argue that:
  - the exclusion of prepayment would create fragmentation and an uneven playing field between EU jurisdictions and asset classes that show very different levels of prepayments;
  - the cost of significant risk transfer transactions would increase significantly, especially for senior tranches;
  - existing prepayment assumptions for securitisation exposures used in other prudential regulations such as the liquidity coverage ratio (LCR) could be efficiently used for the purpose of the WAM.

- 23. Treatment of defaults:** Mixed views were expressed regarding the exclusion of expected defaults from the calculation of the WAM. Market participants in favour of prepayments take the view that expected defaults are widely used in the securitisation market and can easily be estimated based on historical data. On the other hand, it is also considered by some stakeholders that the exclusion of defaults from the calculation of the WAM would allow better comparability and prudence of the WAM model. In addition, the impact of excluding defaults from the determination of the WAM is expected to be minor.
- 24. Treatment of call options other than clean-up calls:** Some respondents are in favour of including time calls in the WAM model, as they are a non-complex feature that are usually clearly documented in the transaction documentation. They also consider that the treatment of call options in the context of the WAM should be aligned with the CRR, which allows options that can be exercised at the sole discretion of one counterparty when calculating capital requirements.
- 25. Implementation and use of the WAM model:** According to most of the respondents, the calculation of the WAM should not be subject to internal model validation. The WAM to be used for regulatory purpose is considered relatively simple, hence it does not need to be subject to the same validation requirement as other models.

## Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses	EBA analysis	Amendments to the proposal
<b>Responses to questions in Consultation Paper EBA/CP/2019/08</b>			
	<b>Interpretation of 'contractual payments due under the tranche'</b>		
<b>Question 1:</b> Do you agree that the contractual payments due under the contract that provides credit protection by virtue of which the credit risk is transferred, and not those contractual payments of the borrowers in relation to the underlying exposures, are the ones to be considered for determining the WAM of a tranche in a synthetic securitisation from a regulatory perspective? If not, please provide evidence supporting your views.	<p>Most of the respondents took the view that the payments received by the originators from the borrowers of the underlying loans and allocated to the unprotected tranches should be treated as 'contractual payments due under the tranche' for calculating the WAM. While in a synthetic transaction there are no contractual payments of the borrowers from a legal point of view, the outstanding guaranteed tranche amounts are dependent on the principal payments of the borrower. For that reason, it was proposed to take into account the reductions in the outstanding amount tranche into consideration for the determination of the WAM.</p>	<p>The EBA agrees that, from an economic point of view, in synthetic securitisations, the maturity of the credit exposures reflects the payments received from the underlying exposures and the allocation of such payments to the tranche holders.</p>	<p>A new paragraph has been added in Section 4.1.2 to specify that the payments from the borrowers of the underlying exposures that are allocated to the reduction of the outstanding amount of the tranches of the synthetic securitisation should be taken into account when determining the WAM.</p>
	<b>Counterintuitive effect on the WAM of the senior tranches</b>		
	<p>Several stakeholders stressed that, within the proposed methodology, the maturity of the retained senior tranches would be greater in</p>	<p>The EBA acknowledges that the proposed approach might result in an unjustified uneven playing field between sequential and pro rata</p>	<p>A new paragraph has been added in Section 4.1.2 to specify that the payments from the borrowers of the underlying exposures that are</p>

Comments	Summary of responses	EBA analysis	Amendments to the proposal
	<p>a transaction with sequential amortisation than in the transactions with pro rata amortisation. Such a result would be counterintuitive, as the expected residual life of a senior tranche will be actually lower in a sequential amortisation scheme, reflecting the lower credit risk associated with senior tranches in such a scheme.</p>	<p>structures in cases of senior tranches.</p>	<p>allocated to the reduction of the outstanding amount of the tranches of the synthetic securitisation should be taken into account when determining the WAM.</p>
<p><b>Question 2:</b> Do you agree that, in the case of funded credit protection, the reimbursement of the collateral pledged, and any interest or coupons collected by the protection providers from the collateral, should be considered contractual payments due under the tranche along with the premia, as referred to between brackets, and highlighted in italic, in paragraph 20 of the rationale; paragraphs 12, 57 and 64 of the draft guidelines; and paragraphs 7, 13 and 14 of the impact assessment? If not, please provide evidence supporting your views.</p>	<p><b>Unbalanced treatment of funded versus unfunded credit protection</b></p> <p>Several stakeholders highlighted that, within the proposed methodology, the WAM will be higher for funded protection than for unfunded protection because, when the securitisation redeems under the unfunded protection, no cash will be paid back. This might incentivise the use of the unfunded type of guarantees even if they are riskier than the funded one.</p>	<p>The EBA acknowledges that the proposed approach might result in unintended consequences on the funded synthetic transactions versus unfunded synthetic transactions.</p>	<p>A unified approach for funded and unfunded credit protection is adopted in the guidelines.</p>

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<p><b>Question 3:</b> Do you agree that zero prepayments should be assumed on the performing portfolio for calculating the WAM of a tranche? Do you think that such assumption has a significant impact on the calculation of risk-weighted exposure amounts for certain asset classes or for certain tranches, depending also on their seniority? If so, please provide evidence supporting your views.</p>	<p><b>Zero prepayments assumptions</b></p> <p>Most of the stakeholders disagreed with the suggested zero prepayments assumptions. They considered that such an assumption would:</p> <ul style="list-style-type: none"> <li>- create fragmentation and an uneven playing field across the EU and across asset classes with generally higher prepayment rates;</li> <li>- have a particular damaging effect on the senior tranche, as the majority of transactions are based on sequential repayments;</li> <li>- make securitisation transaction unviable, as it would not be possible for the originators to achieve significant risk transfer at an economic level.</li> </ul>	<p>Given that prepayment is a long-standing component of the true sale securitisation market and a key component of the modelling and the pricing of transaction, the EBA agrees to allow institutions to take into account expected prepayments for traditional securitisation when data are available and based on prudent assumptions.</p>	<p>Section 4.3.2 of the guidelines has been amended to allow institutions to take into account prepayments for performing true sale securitisation under specific conditions.</p>
<p><b>Question 4:</b> Do you agree that zero defaults should be assumed on the performing portfolio for calculating the WAM of a tranche? Do you think that such assumption has a significant impact on the calculation of risk-weighted</p>	<p><b>Zero defaults assumption</b></p> <p>Mixed views were expressed:</p> <ul style="list-style-type: none"> <li>▪ Stakeholders that were in agreement took the view that the proposal to assume zero defaults for the determination of the WAM would be easy to implement and</li> </ul>	<p>The expected default is not a contractual provision and, therefore, cannot be part of the calculation of the WAM according to the wording of Article 257 of the CRR, which only refers to contractual</p>	<p>No amendment was made to the guidelines.</p>

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<p>exposure amounts for certain asset classes or for certain tranches, depending also on their seniority? If so, please provide evidence supporting your views.</p>	<p>would allow a uniform methodology for the WAM across EU institutions.</p> <ul style="list-style-type: none"> <li>▪ Stakeholders that disagreed argued that: <ul style="list-style-type: none"> <li>- expected default is a standard concept in modelling securitisation and most of the transactions already calculate the WAL both with and without expected defaults;</li> <li>- inclusion of expected defaults would be consistent with the EBA guidelines on significant risk transfer and RTS on KIRB.</li> </ul> </li> </ul>	<p>payments. In addition, the EBA's view is that the impact of excluding defaults on the WAM would not be significant and would depend on waterfall structures, while it would imply a significant increase in complexity.</p>	
<p><b>Question 5:</b> Do you consider the assumption that, in the case of the existing non-performing exposures at the time of the calculation of WAM, the principal and interest payments in respect of such exposures throughout the life of the securitisation should be assumed zero, and the asset model should also assume that no exposure will cure in the future, reasonable? If not, would the</p>	<p>Mixed views were expressed:</p> <ul style="list-style-type: none"> <li>▪ Stakeholders in favour considered that that assumption is reasonable, as the modelling could be very divergent between asset classes, jurisdictions and institutions.</li> <li>▪ Stakeholders that were in disagreement argued that recoveries and payments from cured exposures are key parameters when analysing an investment from the investor side, and it would be an</li> </ul>	<p>For the sake of simplicity and transparency, the EBA considers that principal and interest payments throughout the life of the securitisation should be assumed zero, and the asset model should also assume that no exposure will cure in the future for existing non-performing exposures. Such a prudent approach will also</p>	<p>No amendment was made to the guidelines.</p>

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<p>added complexity introduced by a differentiated modelling of payments received on non-performing exposures be justified in terms of the impact on risk-weighted exposure amounts? If so, could you provide evidence supporting your views? Please substantiate your views.</p>	<p>oversimplification to assume zero future interest and principal payments, as the originator has an extensive knowledge of the historic performance of the securitised portfolio.</p>	<p>ensure that these guidelines are implemented uniformly across EU institutions and jurisdictions.</p>	
<p><b>Question 6:</b> In synthetic securitisations, do you agree that no modelling of future non-occurred losses should be allowed in order to calculate the future outstanding balance of the underlying portfolio and the tranches? Or do you think that the modelling of losses should be taken into account? If so, could you provide the rationale supporting your views and the impact on risk-weighted exposure amounts?</p>	<p>Like the answers to question 5 for traditional securitisations, mixed views were also expressed.</p> <p>In particular, regarding synthetic transactions, some stakeholders claimed that when significant credit risk has been transferred to third parties they are subject to a comprehensive assessment which focuses on the performance of the transaction throughout its lifetime. In this context, it can be assumed that the originator has a good knowledge of the future performance of the portfolio.</p>	<p>For similar reasons to those stated in question 5, the EBA considers that no modelling of future non-occurred losses should be done in the case of synthetics either.</p>	<p>No amendment was made to the guidelines.</p>
<p><b>Question 7.</b> In synthetic securitisations, do you agree that</p>	<p>Most respondents took the view that optional features should be considered in the calculation of the WAM:</p>	<p>The guidelines allow institutions to take into account clean-up calls only,</p>	<p>Amendments have been made to Section 4.5.4 to allow institutions to take into</p>

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<p>only clean-up calls in accordance with Article 245(4)(f) of the CRR should be taken into account to determine the WAM? In your view, should time calls, which can be exercised by the protection buyer after the WAL of the underlying portfolio (as defined in paragraph 53 of the Guidelines on the STS criteria for ABCP securitisation), also be taken into account? If so, could you provide the rationale supporting your views and the impact on risk-weighted exposure amounts?</p>	<ul style="list-style-type: none"> <li>- time calls are a non-complex feature that is usually clearly documented in the transaction documentation and can be easily modelled;</li> <li>- in certain transactions, time calls are easily predictable, especially when they have a huge benefit for the originator, so it may be extremely likely that they will be exercised;</li> <li>- time calls are also taken into account in other areas of the CRR, which allows options that can be exercised at the sole discretion of one counterparty to be recognised when calculating capital requirements (e.g. amount of a derivative exposure under the counterparty credit risk).</li> </ul>	<p>in the case of traditional securitisations, but they are more flexible in cases of originators in synthetic securitisations because there is a specific treatment for maturity mismatches in Article 252 of the CRR that adjusts the risk weights of the synthetic securitisation positions with those of the securitised portfolio.</p>	<p>account other types of calls than clean-up calls to determine the WAM in cases of synthetic securitisations.</p>
<p><b>Question 8.</b> What are your views on the model validation and quality review of the asset and liability models and on due diligence on third-party model providers? Do you perceive it as too burdensome? If so, please provide alternative proposals to account for</p>	<p>Most of the respondents viewed the suggested model validation as too burdensome. The calculation of the WAM should not be subject to internal model validation as it is considered as relatively simple.</p> <p>Some respondents also highlighted the need for a clear separation between the models provided by established third-party and</p>	<p>The EBA agrees to clarify the conditions regarding the use of third parties for the validation of the WAM methodology so that institutions can consider using them if deemed relevant and/or necessary.</p>	<p>Amendments have been made to Section 4.6 of the guidelines to allow institutions to have the WAM in-house models or WAM third-party models reviewed by an independent third party under specific conditions.</p>



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<p>compliance of third-party model providers with these guidelines and for the assessment of the quality and accuracy of the asset and liability models.</p>	<p>internal models developed by institutions. In particular, it is considered that it is not possible for institutions using third-party models to perform a validation, as it would require an institution to examine internal documents, scripts and codes of the third party.</p>		
<p><b>Question 9.</b> Are there any other issues that you would consider necessary to comment on? If so, please provide them with the alternatives to the wording adopted in these draft guidelines.</p>	<p><b>Loan-level data</b> Some respondents considered that it would be very difficult and impracticable to calculate loan-level cash flows in the asset model from both an accuracy and an efficiency perspective.</p>	<p>The EBA considers that in the transparency templates, and the securitisation repositories under the Securitisation Regulation, institutions can easily access loan-by-loan information about the securitised portfolio, which is market practice. In addition, the guidelines already make exceptions where appropriate due to granularity, in which case the forecast may be modelled on the basis of homogeneous sub-pools of the securitised exposures for asset types such as trade receivables.</p>	<p>No amendment was made to the guidelines.</p>

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<b>Interaction between the asset model and liability triggers</b>	One respondent suggested that the WAM methodology should take into account future changes in cash flows not only when they are scheduled to occur on a certain date but also when they will happen on the occurrence of a trigger event that is projected to occur by a certain date based on the asset model.	The EBA agrees that they could be taken into account as long as the change can be determined in a completely predetermined manner in a future period at the calculation date of the WAM.	Amendments have been made in several parts of the guidelines.
<b>Incomplete data</b>	In case the data are incomplete, institutions should be allowed to use the WAM provided that they apply the most conservative assumptions in the calculation.	The EBA agrees that the transaction selection criteria could be applied for the purpose of complementing the missing information on the underlying exposures.	The guidelines have been amended accordingly.
<b>Interest rates</b>	It is considered that the proposed assumption whereby the interest value must be assumed to be constant for the life of the transaction based on the latest observation date would depart significantly from the market practice. It is proposed to use instead the available future values of commonly used interest rate benchmarks for calculating the WAM.	The EBA is of the view that only changes in interest rates that can be determined in a completely predetermined manner in a future period at the calculation date of the WAM could be taken into account.	No amendment was made to the guidelines.
<b>Revolving securitisations</b>	An alternative method is suggested in relation to positions in revolving securitisations as	The EBA agrees with the proposal.	Amendments have been made to take it into account in

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	<p>follows. (i) Determine the scheduled maturity of each underlying asset as of the WAM determination date. (ii) For each underlying asset scheduled to mature before the end of the replenishment/revolving period, adjust the scheduled maturity to equal the sum of its current maturity plus the longest permitted maturity (in the example, 5 years) of an eligible loan that can be added to the pool during the replenishment/revolving period. (In the example, Loan 1 has a current maturity of 0.45 years and adjusted maturity of 5.45 years). (iii) For each underlying asset scheduled to mature later than the end of the revolving period, the final maturity will not be adjusted. (iv) Calculate the WAM of the tranche using the adjusted or unadjusted maturities of the underlying assets.</p>		<p>paragraph 31 of the guidelines.</p>
	<p><b>Simplification of the WAM methodology</b> Several stakeholders were of the view that some modelling items (such as the cash accounts) add unnecessary complexity while having very limited impact on the WAM.</p>	<p>The EBA agrees with the comment.</p>	<p>The guidelines now specify that institutions are not required to take into account the income coming from the deposit account and the other short-term investments when determining the contractual payment due to the SSPE, and they allow institutions to apply</p>

<b>Comments</b>	<b>Summary of responses</b>	<b>EBA analysis</b>	<b>Amendments to the proposal</b>
			the transaction selection criteria for the purpose of complementing the missing information on the underlying exposures.