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M E M O R A N D U M

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Updated Pillar 2 method for assessing flowback risk associated with securitisation

Summary
Finansinspektionen (FI) is updating its method for assessing flowback risks for individual banks associated with securitisation.[1] The aim is to decide, where applicable, on an additional own funds requirement under Pillar 2 for flowback risks associated with securitisations. This enables us to safeguard that a bank is sufficiently covering the flowback risks to which it is exposed.

This memorandum replaces FI's memorandum from 2017, "FI:s kapitalbedömningsmetod inom pelare 2 för systemrisk vid värdepapperisering".[2] In that memorandum, we described how securitisations, given certain conditions, could introduce systemic risks associated with securitisation that are not covered by Pillar 1.

Securitisations can be difficult to refinance, for example when the market is unstable or investors are demonstrating weaker demand. When credits can no longer be financed via a securitisation, and if the borrower continues to have a need for financing, FI sees that a bank is faced with two options. The bank can choose to renew/extend the loans outside of the securitisation or not.

Banks seldom have contractual obligations to extend/renew credits as they mature, even if the borrower's continues to have a need for financing. However, FI makes the assessment that a bank, in addition to its contractual obligations, in most cases will offer financing to borrowers whose credits can no longer be financed through a securitisation. The banks do this to protect their brand, limit other reputational risks, and minimise credit losses. As a consequence, there can be a sudden and unexpected deterioration in the bank's capital situation since the loans are flowing back to the bank without the mitigating effect of the securitisation on the capital requirement. The flowback

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[1] In this memorandum, the term *banks* is used for all institutions (banks, credit market companies and securities companies) that are subject to the capital adequacy rules.
[2] FI Ref. 16-17820. An English translation is available at www.fi.se.

thus risks further stressing the bank's capital, which makes the bank more vulnerable.

FI will apply the updated method to assessing flowback risks associated with securitisation as follows:

- The method will be applied to banks that perform traditional and synthetic securitisations, where the terms for significant credit risk transfer to a third party are viewed to be met.
- The method will be applied to banks where the flowback risk, following an overall capital assessment, is judged to be material. FI makes the assessment that this will initially apply to banks in Supervision Categories 1 and 2. In some exceptional cases, it may also apply to banks in Supervisions Categories 3 and 4. After a separate assessment, the method will also in this case be applied to these banks.
- FI intends to decide on an additional own funds requirement for flowback risks associated with securitisation if at least one of the two following conditions are met:
    - the bank's total capital ratio decreases by at least 50 basis points during a future twelve-month period as a result of the flowback.
    - the exposure value[3] for the bank's securitised credits exceeds 15 per cent of the bank's total exposures value in relevant exposures classes.[4]
- Securitisations that are judged to entail low flowback risks will be exempt from the approach.

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[3] Exposure value refers to the amounts that are set out in Articles 111 and 166 of the Capital Requirements Regulation.
[4] Exposure class refers to the exposure classes that are set out in Articles 112 and 147 of the Capital Requirements Regulation.