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Regulatory capital changes from 1 November 2016: ECAI credit mappings for banks and IFPRU investment firms

On 12 October 2016, the final implementing technical standards ("ITS") on the mapping of external credit assessments under the EU Capital Requirements Regulation ("CRR") were published in the EU Official Journal. As a result, these new credit mappings will come into force on **1 November 2016**. Firms should ensure that they are applying them from that date for the purposes of calculating credit risk under the CRR and when filing regulatory capital returns. The [appendices](#) to this briefing contain a comparison of the current credit mappings and the new replacement credit mappings.

The ITS are contained in the two separate regulations:

- [Commission Implementing Regulation \(EU\) 2016/1799](#), which sets out the credit mappings for non-securitisation exposures under the CRR; and
- [Commission Implementing Regulation \(EU\) 2016/1801](#), which sets out the credit mappings for securitisation exposures under the CRR.

In addition, another regulation ([Commission Implementing Regulation \(EU\) 2016/1800](#)) sets out credit mappings for the purposes of the Solvency II regime applicable to insurers. The Solvency II rules are not discussed further in this briefing.

The ITS replace the current domestic mapping tables. The final ITS represent a broadly positive result for credit institutions and investment firms that are subject to the CRR credit risk requirements. Essentially, with some relatively minor exceptions, they replicate the pre-CRR position with no fundamental changes to the calibration of external credit ratings to credit quality steps for both securitisation and non-securitisation exposures. In the short term at least, this will come as a relief to many firms, as a fundamental revision of the credit mappings could have resulted in significant increases in regulatory capital requirements. In addition, the new ITS provide mappings for a significant number of newer rating agencies for the first time.

In this briefing, we explain the background to the ITS and provide a short summary of the final position. We also briefly consider the potential impact of future developments on the treatment of credit risk requirements under the CRR for securitisations.

BACKGROUND

On 1 January 2014, the revised regulatory capital rules in the CRR took effect across the EU for banks and in-scope investment firms (which, in the UK, are designated as "IFPRU investment firms"). A significant part of the CRR is dedicated to the determination of firms' own funds requirements and, in turn, a significant proportion of the provisions relating to own funds requirements address the calculation of credit risk requirements. The relevant provisions differ depending upon whether a particular exposure of the firm is an exposure to a securitisation or not.

When using credit ratings issued by external credit assessment institutions ("**ECAIs**"), firms should ensure that they comply with the general requirements in Articles 138 to 141 of the CRR. These provisions address issues such as which credit assessments may be used, consistency of use and long-term versus short-term credit assessments.

TREATMENT OF EXPOSURES OTHER THAN SECURITISATION EXPOSURES

Firms that are subject to the CRR must apply one of two different approaches to the determination of the credit risk component of their own funds requirements: either the default Standardised Approach or, with the permission of their regulator, the Internal Ratings Based ("**IRB**") Approach.

Under the general Standardised Approach, the relevant provisions contain a number of rules specifying the risk weightings that must be applied to a firm's exposures (other than securitisation exposures – see below) in order to determine risk-weighted exposure amounts. In turn, those risk-weighted exposure amounts determine the amount of regulatory capital that the firm must hold to cover the credit risk arising in relation to its activities.

For certain types of exposures (for example, exposures to corporates or exposures to public sector entities) which have been allocated an external credit rating, the Standardised Approach requires the firm to determine the applicable "credit quality step" ("**CQS**") for each exposure. Each CQS then corresponds to a specified risk weighting set out in the CRR. For these purposes, the CRR only permits ratings that have been issued (or endorsed) by an ECAI (i.e. a credit rating agency recognised under EU law) to be used to determine the CQS.

However, the CRR does not itself state how an ECAI credit rating should be translated into a CQS. This is the purpose of the credit mappings contained in the ITS. Until now, the FCA has indicated in IFPRU 4.2 that firms should continue to apply the [pre-CRR mapping tables](#) issued by the Financial Services Authority under the UK Capital Requirements Regulations 2006 to determine how external ratings should be converted into CQSs. The PRA has specified identical mapping tables in [Supervisory Statement SS10/13](#) which PRA-regulated firms have been required to use for these purposes. From 1 November 2016 (when the ITS enter into force), firms should in both cases be using the new credit mapping tables in the ITS instead. This is a further example of standardisation across the EU.

As regards non-securitisation exposures, the IRB Approach does not rely on CQSs mapped to credit ratings issued by ECAIs. Instead, it permits firms to use their own internal models to determine the credit risk associated with different exposures, subject to compliance with a large number of highly complex rules. As a result, the non-securitisation ITS are not relevant for firms that have adopted the IRB Approach. However, in the vast majority of cases investment firms will use the Standardised Approach as they will not have the resources to operate complex internal models that would be necessary to move to the IRB Approach.

TREATMENT OF SECURITISATION EXPOSURES

The CRR prescribes a complex regime in relation to exposures incurred by firms in relation to securitisations, and again contains different rules depending upon whether a firm is applying the Standardised Approach or the more complex IRB Approach.

Under the Standardised Approach, the firm is required to determine the CQS of an externally rated securitisation position and then to determine the regulatory capital risk weighting that corresponds to that CQS. There are then various potential modifications to this basic approach that may apply in order to reflect the specific circumstances of a particular securitisation. Unrated securitisation positions are subject to a maximum fall-back risk weighting.

However, unlike for non-securitisation exposures, firms that are applying the IRB Approach in the context of a securitisation exposure are required to apply a "**Ratings Based Method**" if the securitisation position is rated, or is a position in relation to which a rating may be inferred. As with the Standardised Approach, the Ratings Based Method sets out a number of CQSs and their resulting risk weightings for this purpose (although these are calibrated differently from the CQSs and risk weightings under the Standardised Approach). Complex rules apply in relation to unrated securitisations in this context, where the institution may be permitted to estimate certain parameters in accordance with its own internal risk models, although there is still a maximum fall-back risk weighting if this is not possible.

Under both the Standardised Approach and the Ratings Based Method component of the IRB Approach, the CRR again does not fully specify how an external credit rating should be converted into a CQS. Instead, the ITS contain a set of credit mapping tables for securitisation positions which firms must apply from 1 November 2016 in conjunction with the CRR provisions.

SUMMARY OF THE FINAL MAPPING TABLES IN THE ITS

Broadly speaking, neither the securitisation ITS nor the non-securitisation ITS represent significant changes from the current position, although in certain cases the new mappings are not identical to the pre-existing rules and there may therefore be a limited resulting impact on firms' capital requirements.

NON-SECURITISATION ITS

As required under the CRR, the new mappings now cover all current recognised ECAIs, rather than merely the four rating agencies (DBRS, Fitch, Moody's and Standard & Poor's) that were covered under the old mappings. As a result, firms may potentially rely on a wider population of credit ratings in order to avoid being required to use default rules relating to unrated non-securitisation exposures (which are generally less favourable). The non-securitisation ITS also set out quantitative and qualitative factors and benchmarks that should be used for future assessment of the mapping of ECAI credit ratings.

As some of the newly mapped ECAIs are comparatively new market entrants and there was limited quantitative data available in order to assess the performance of credit ratings issued by those ECAIs, the recitals to the ITS note that less weight has currently been given to quantitative factors for those rating agencies. The initial mapping for these new entrants is therefore comparatively relaxed (resulting in more favourable CQSs initially being assigned to their ratings), but as more quantitative data is collected, this may result in future revisions to the current mappings.

As regards the four most established ECAIs that were mapped in the pre-CRR mapping tables (i.e. DBRS, Fitch, Moody's and Standard & Poor's), the new mappings are largely unchanged from the pre-CRR versions. However, there have been some small amendments in relation to certain short-term credit ratings which may result in some increased risk weightings and correspondingly higher capital requirements.

For ease of reference, we have set out a comparison of the pre-CRR mappings and those under the new non-securitisation ITS for the four most established ECAIs in the tables in [Appendix 1](#) to this briefing. We have also

set out the applicable risk weightings under the CRR corresponding to the relevant mappings. The tables in the Appendix are not intended to be comprehensive and are provided as a summary overview for reference purposes only – firms should refer to the definitive tables in the ITS themselves when applying the rules in the CRR.

SECURITISATION ITS

As with the non-securitisation ITS, the securitisation ITS include mappings for ratings issued by a wide range of other ECAIs for the first time, thereby permitting such ratings to be used when calculating the regulatory capital requirements resulting from securitisation positions.

Institutions will be relieved that as regards the four most established ECAIs, the new mappings are identical to the pre-CRR mappings both in relation to short and long-term ratings. As a result, a securitisation position with a rating from any of those ECAIs will attract the same risk weighting as under the existing domestic UK mappings.

We have set out a comparison of the relevant pre-CRR risk mappings and the mappings under the new securitisation ITS for the four most established ECAIs in [Appendix 2](#) to this briefing, alongside the relevant risk weighting under the CRR which applies in each case. As with Appendix 1 above, the tables in Appendix 2 are intended to be only a summary overview of the relevant mappings and firms should ensure that they refer to the final definitive versions in the ITS when applying the relevant rules.

FUTURE DEVELOPMENTS FOR SECURITISATIONS

The final ITS largely mirror the draft proposals previously put forward by the European Supervisory Authorities (in the case of the non-securitisation ITS) or the European Banking Authority ("EBA") alone (in the case of the securitisation ITS). In its narrative commentary on the securitisation proposals, the EBA noted some important caveats. The first was that the securitisation ITS were being put forward on a relatively short-term basis only – i.e. the EBA anticipated that it would continue to monitor the position and could in the future recommend that revised credit mappings be adopted if it becomes clear that the new ITS are inappropriate. Secondly, and on a related point, the EBA noted that it would have been justified in developing revised securitisation mappings based on a purely quantitative assessment of the historical performance of ECAIs' ratings, but chose not to do so at the present time. In light of the EBA's stated intention to move to a quantitative mapping methodology in the future, if future default statistics suggest that an ECAI's securitisation credit ratings have not been mapped appropriately, the EBA may recommend adjusting the mappings for the relevant ECAI, potentially resulting in a more conservative regulatory capital treatment being applied to securitisation exposures that are rated by that ECAI.

The EBA also noted that the existing regulatory capital framework under the CRR will be subject to review by the European Commission in the future. Depending on the outcome of that review, it is possible that the approach to the regulatory capital treatment of credit risk (and by extension, the calibration of ECAI credit mappings for such purposes) will be subject to significant reform. As part of that review process, the EBA has suggested that it may lobby for a shift to a more quantitative approach to credit mappings in the context of securitisations.

It should also be noted that as part of its proposals for the EU's "Capital Markets Union", the European Commission has proposed significant reforms to the regulatory capital treatment of securitisations. The proposed new rules are at an early stage in the legislative process and are highly complicated, but essentially they would repeal the entirety of the existing rules relating to the credit risk of securitisation exposures in the CRR and replace these with new provisions which are intended to be more risk-sensitive. In order to give effect to these revised proposals, the EBA may need to revisit the mapping of ECAI credit ratings for securitisations in due course.

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APPENDIX 1

COMPARISON OF GENERAL (NON-SECURITISATION) CREDIT MAPPING TABLES UNDER THE STANDARDISED APPROACH

NOTE: The tables in this appendix are intended to provide only a summary overview of the move from the pre-1 November 2016 existing UK mapping tables to the new mapping tables adopted by the Commission for use from 1 November 2016. They cover only the most established rating agencies (DBRS, Fitch, Moody's and Standard & Poor's) for which mappings are available in both the old and new mapping sets. These tables are not intended to be comprehensive of all rating scales used by these rating agencies and when applying the relevant credit risk rules in the CRR in relation to non-securitisation positions, firms should refer to the definitive mapping tables in Annex III of [Commission Implementing Regulation \(EU\) 2016/1799](#).

LONG-TERM CREDIT RATINGS

CQS	CURRENT (PRE-CRR) UK CREDIT MAPPING				NEW CRR CREDIT MAPPING				CRR RISK WEIGHTING						
	DBRS	FITCH	MOODY'S	S&P	DBRS	FITCH	MOODY'S	S&P	CENTRAL GOVTS / BANKS	PUBLIC SECTOR ENTITIES (SOVEREIGN METHOD)*	INSTITUTIONS			CORPORATES	COVERED BONDS
											UNRATED (SOVEREIGN METHOD)**	RATED – RESIDUAL MATURITY > 3 MONTHS	RATED – RESIDUAL MATURITY 3 MONTHS OR LESS		
1	AAA to AA (low)	AAA to AA-	Aaa to Aa3	AAA to AA-	AAA AA	AAA AA	Aaa Aa	AAA AA	0%	20%	20%	20%	20%	20%	10%
2	A (high) to A (low)	A+ to A-	A1 to A3	A+ to A-	A	A	A	A	20%	50%	50%	50%	20%	50%	20%
3	BBB (high) to BBB (low)	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBB	BBB	Baa	BBB	50%	100%	100%	50%	20%	100%	20%
4	BB (high) to BB (low)	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BB	BB	Ba	BB	100%	100%	100%	100%	50%	100%	50%
5	B (high) to B (low)	B+ to B-	B1 to B3	B+ to B-	B	B	B	B	100%	100%	100%	100%	50%	150%	50%
6	CCC (high) and below	CCC+ and below	Caa1 and below	CCC+ and below	CCC CC C D	CCC CC C RD D	Caa Ca C C	CCC CC R SD/D	150%	150%	150%	150%	150%	150%	100%

* In accordance with Article 116 CRR, this sovereign method means that exposures to public sector entities for which a credit assessment by a nominated ECAI is not available must be assigned a risk weight in accordance with the CQS that would be assigned to exposures to the central government of the jurisdiction in which that public sector entity is incorporated. If a credit assessment by a nominated ECAI is available, the exposure should be treated in accordance with the provisions applying to rated institutions instead.

** In accordance with Article 121 CRR, exposures to institutions for which a credit assessment by a nominated ECAI is not available must be assigned a risk weight in accordance with the CQS that would be assigned to exposures to the central government of the jurisdiction in which that institution is incorporated. If a credit assessment by a nominated ECAI is available, the exposure should be treated in accordance with the provisions applying to rated institutions.

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SHORT-TERM CREDIT RATINGS

CQS	CURRENT (PRE-CRR) UK CREDIT MAPPING				NEW CRR CREDIT MAPPING				CRR RISK WEIGHTING
	DBRS	FITCH	MOODY'S	S&P	DBRS	FITCH	MOODY'S	S&P	INSTITUTIONS AND CORPORATES
1	R-1 (high) R-1 (middle) R-1 (low)	F1+ F1	P-1	A-1+ A-1	R-1 (high) R-1 (middle)	F1+	P-1	A-1+	20%
2	R-2 (high), R-2 (middle) R-2 (low)	F2	P-2	A-2	R-1 (low)	F1	P-2	A-1	50%
3	R-3	F3	P-3	A-3	R-2 R-3	F2 F3	P-3	A-2 A-3	100%
4	R-4 R-5	Below F3	NP	B-1 B-2 B-3 C	R-4 R-5 D	B C RD D	NP	B C D	150%

COLLECTIVE INVESTMENT UNDERTAKINGS RATINGS

CQS	CURRENT (PRE-CRR) UK CREDIT MAPPING			NEW CRR CREDIT MAPPING			CRR RISK WEIGHTING
	FITCH	MOODY'S	S&P	FITCH	MOODY'S	S&P	UNITS OR SHARES IN CIUs
1	AAA to AA-	Aaa to Aa3	AAAf to AA-f	AAA AA	Aaa Aa	AAAf AAf	20%
2	A+ to A-	A1 to A3	A+f to A-f	A	A	Af	50%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+f to BBB-f	BBB	Baa	BBBf	100%
4	BB+ to BB-	Ba1 to Ba3	BB+f to BB-f	BB	Ba	BBf	100%
5	B+ to B-	B1 to B3	B+f to B-f	B	B	Bf	150%
6	CCC+ and below	Caa1 and below	CCC+f and below	CCC CC C RD D	Caa Ca C	CCCf	150%

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APPENDIX 2

COMPARISON OF SECURITISATION CREDIT MAPPING TABLES

NOTE: The tables in this appendix are intended to provide only a summary overview of the move from the pre-1 November 2016 existing UK mapping tables to the new mapping tables adopted by the Commission for use from 1 November 2016. They cover only the most established rating agencies (DBRS, Fitch, Moody's and Standard & Poor's) for which mappings are available in both the old and new mapping sets. These tables are not intended to be comprehensive of all rating scales used by these rating agencies and when applying the relevant credit risk rules in the CRR in relation to securitisation positions, firms should refer to the definitive mapping tables in Annex I (or if using the Ratings Based Method, Annex II) of [Commission Implementing Regulation \(EU\) 2016/1801](#).

STANDARDISED APPROACH – LONG-TERM CREDIT RATINGS

CQS	CURRENT (PRE-CRR) UK CREDIT MAPPING				NEW CRR CREDIT MAPPING				CRR RISK WEIGHTING	
	DBRS	FITCH	MOODY'S	S&P	DBRS	FITCH	MOODY'S	S&P	SECURITISATION	RE-SECURITISATION
1	AAA to AA (low)	AAA to AA-	AAA to Aa3	AAA to AA-	AAA(sf) to AA (low)(sf)	AAAsf to AA-sf	Aaa(sf) to Aa3(sf)	AAA(sf) to AA-(sf)	20%	40%
2	A (high) to A (low)	A+ to A-	A1 to A3	A+ to A-	A (high)(sf) to A (low)(sf)	A+sf to A-sf	A1(sf) to A3(sf)	A+(sf) to A-(sf)	50%	100%
3	BBB (high) to BBB (low)	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBB (high)(sf) to BBB (low)(sf)	BBB+sf to BBB-sf	Baa1(sf) to Baa3(sf)	BBB+(sf) to BBB-(sf)	100%	225%
4	BB (high) to BB (low)	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BB (high)(sf) to BB (low)(sf)	BB+sf to BB-sf	Ba1(sf) to Ba3(sf)	BB+(sf) to BB-(sf)	350%	650%
5	B (high) and below	B+ and below	B1 and below	B+ and below	Will now fall within "All other" category below				1,250%*	1,250%*
All other	"All other" category did not exist under pre-CRR mapping				Below BB (low)(sf)	Below BB-sf	Below Ba3(sf)	Below BB-(sf)	1,250%	1,250%

* Although there is no CQS 5 under the EBA's new proposed CRR credit mapping, where institutions have been applying the pre-CRR credit mapping tables for the purposes of the provisions governing securitisation exposures under the CRR, any ratings falling within the CQS 5 category would nonetheless have attracted a 1,250% risk weighting as they would fall within the "all other" category in Article 251 CRR.

STANDARDISED APPROACH – SHORT-TERM CREDIT RATINGS

CQS	CURRENT (PRE-CRR) UK CREDIT MAPPING				NEW CRR CREDIT MAPPING				CRR RISK WEIGHTING	
	DBRS	FITCH	MOODY'S	S&P	DBRS	FITCH	MOODY'S	S&P	SECURITISATION	RE-SECURITISATION
1	R-1 (high) to R-1 (low)	F1+, F1	P-1	A-1+, A-1	R-1 (high)(sf) to R-1 (low)(sf)	F1+sf, F1sf	P-1(sf)	A-1+(sf), A-1(sf)	20%	40%
2	R-2 (high) to R-2 (low)	F2	P-2	A-2	R-2 (high)(sf) to R-2 (low)(sf)	F2sf	P-2(sf)	A-2(sf)	50%	100%
3	R-3	F3	P-3	A-3	R-3(sf)	F3sf	P-3(sf)	A-3(sf)	100%	225%
All other	All short-term ratings below R3	Below F3	NP	Below A-3	Below R-3(sf)	Below F3sf	NP(sf)	Below A-3(sf)	1,250%	1,250%

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INTERNAL RATINGS BASED APPROACH (RATINGS BASED METHOD) – LONG-TERM CREDIT RATINGS

CQS	CURRENT (PRE-CRR) UK CREDIT MAPPING				NEW CRR EBA CREDIT MAPPING				CRR RISK WEIGHTING				
	DBRS	FITCH	MOODY'S	S&P	DBRS	FITCH	MOODY'S	S&P	SECURITISATION			RE-SECURITISATION	
									SENIOR TRANCHE	BASE	NON-GRANULAR POOL	SENIOR TRANCHE*	NON-SENIOR TRANCHE
1	AAA	AAA	Aaa	AAA	AAA(sf)	AAA(sf)	Aaa(sf)	AAA(sf)	7%	12%	20%	20%	30%
2	AA (high) to AA (low)	AA	Aa	AA	AA (high)(sf) to AA (low)(sf)	AA+sf to AA-sf	Aa1(sf)	AA+(sf) to AA-(sf)	8%	15%	25%	25%	40%
3	A (high)	A+	A1	A+	A (high)(sf)	A+sf	A1(sf)	A+(sf)	10%	18%	35%	35%	50%
4	A	A	A2	A	A(sf)	Asf	A2(sf)	A(sf)	12%	20%		40%	65%
5	A (low)	A-	A3	A-	A (low)(sf)	A-sf	A3(sf)	A-(sf)	20%	35%		60%	100%
6	BBB (high)	BBB+	Baa1	BBB+	BBB (high)(sf)	BBB+sf	Baa1(sf)	BBB+(sf)	35%	50%		100%	150%
7	BBB	BBB	Baa2	BBB	BBB(sf)	BBBsf	Baa2(sf)	BBB(sf)	60%	75%		150%	225%
8	BBB (low)	BBB-	Baa3	BBB-	BBB (low)(sf)	BBB-sf	Baa3(sf)	BBB-(sf)	100%			200%	350%
9	BB (high)	BB+	Ba1	BB+	BB (high)(sf)	BB+sf	Ba1(sf)	BB+(sf)	250%			300%	500%
10	BB	BB	Ba2	BB	BB(sf)	BBsf	Ba2(sf)	BB(sf)	425%			500%	650%
11	BB (low)	BB-	Ba3	BB-	BB (low)(sf)	BB-sf	Ba3(sf)	BB-(sf)	650%			750%	850%
All other	Below BB (low)	Below BB-	Below Ba3	Below BB-	Below BB (low)(sf)	Below BB-sf	Below Ba3(sf)	Below BB-(sf)	1,250%				

* A position in a senior tranche of a re-securitisation may only be treated as a senior tranche for these purposes if none of the underlying exposures in the re-securitisation are themselves re-securitisation exposures. Otherwise, the risk-weighting in the "non-senior tranche" column must be applied instead.

INTERNAL RATINGS BASED APPROACH (RATINGS BASED METHOD) – SHORT-TERM CREDIT RATINGS

CQS	CURRENT (PRE-CRR) UK CREDIT MAPPING				NEW CRR EBA CREDIT MAPPING				CRR RISK WEIGHTING				
	DBRS	FITCH	MOODY'S	S&P	DBRS	FITCH	MOODY'S	S&P	SECURITISATION			RE-SECURITISATION	
									SENIOR TRANCHE	BASE	NON-GRANULAR POOL	SENIOR TRANCHE*	NON-SENIOR TRANCHE
1	R-1 (high) to R-1 (low)	F1+ F1	P-1	A-1+ A-1	R-1 (high)(sf) to R-1 (low)(sf)	F1+sf F1sf	P-1(sf)	A-1+(sf), A-1(sf)	7%	12%	20%	20%	30%
2	R-2 (high) to R-2 (low)	F2	P-2	A-2	R-2 (high)(sf) to R-2 (low)(sf)	F2sf	P-2(sf)	A-2(sf)	12%	20%	35%	40%	65%
3	R-3	F3	P-3	A-3	R-3(sf)	F3sf	P-3(sf)	A-3(sf)	60%	75%		150%	225%
All other	All short-term ratings below R-3	Below F3	All short-term ratings below A-3, P-3 and F3	All short-term ratings below A-3	Below R-3(sf)	Below B**	NP(sf)	Below A-3(sf)	1,250%				

* A position in a senior tranche of a re-securitisation may only be treated as a senior tranche for these purposes if none of the underlying exposures in the re-securitisation are themselves re-securitisation exposures. Otherwise, the risk-weighting in the "non-senior tranche" column must be applied instead.

** It is not clear that this reference to "Below B" was intended, as this raises a question about the treatment that should be applied to a securitisation position with a short-term B (i.e. speculative short-term credit quality) rating from Fitch. The ITS may have meant either "Below F3" or "B or below", with the intention that a B-rated position should attract a 1,250% risk weighting under the CRR (which would then produce identical treatment to the position in the pre-CRR mappings).