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Chapter 12

How does securitization impact banks' regulatory capital?

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• [Securitization Accounting 12th edition](#) | May 2026

Regulatory capital: An overview

Banks are required to maintain adequate levels of regulatory capital to absorb unexpected financial losses, protect depositors, and support the broader financial marketplace and economy. Banks are subject to multiple sets of regulatory rules based on their overall size and business complexity including Basel, Comprehensive Capital Analysis and Review (Stress Testing), and the global systemically important bank (G-SIB) surcharge. This chapter will primarily focus on the Basel regulatory capital rules for securitization exposures. Also included later in the chapter are high-level summaries of Basel Liquidity and Leverage frameworks.

Basel Framework overview

The Basel Framework, developed by the Basel Committee on Banking Supervision (BCBS), is a set of international regulatory standards designed to ensure that financial institutions maintain adequate capital to cover their risks, improve risk management, and promote financial stability globally. Originating from the Basel Accord in 1988 (Basel I), the framework has evolved through Basel II and Basel III, each iteration addressing complexities and systemic risks exposed by financial crises.

The Basel Framework offers two distinct methodologies for calculating risk: the standardized and advanced approaches, each catering to different types of banking institutions based on their complexity and size. The standardized approaches (SA) in the Basel Framework are prescriptive and simpler, relying on external ratings and predefined formulas to assess various types of risk, making them suitable for smaller or less complex banks. In contrast, the advanced approaches (AA) allow banks to use their internal models to evaluate risks, providing a more tailored risk assessment but requiring rigorous validation and regulatory approval, typically used by larger, more complex institutions. The Basel Framework utilizes risk-weighted assets (RWAs) to determine the minimum amount of capital that banks must hold, ensuring that this capital is aligned with the risks the bank undertakes.

The Basel Framework serves as a guideline, and countries can adapt the rules to fit their national banking systems. The core principles are generally adopted worldwide, but the specifics can vary. The United States has implemented most Basel III regulations but adapted them to fit its complex financial system. For instance, the US has stricter

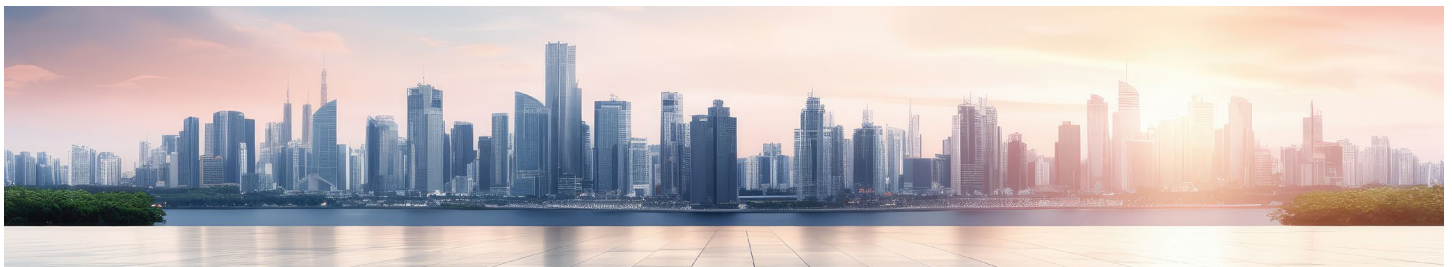
leverage ratios and earlier implementation dates for some Basel III components. The European Union implements Basel standards through the Capital Requirements Directive and Regulation. European banks often use the internal ratings-based approach available under the AA more extensively than US banks.

Regulatory capital

Basel III regulatory capital requirements are designed to ensure banks maintain adequate levels of capital to absorb unexpected financial losses. The Basel rules specify the types of financial instruments that qualify as regulatory capital and, separately, also define minimum capital levels using a tiered approach, as follows:

$$\frac{\text{Regulatory capital}}{\text{Risk-weighted assets}} \geq \text{Minimum capital ratios}$$

- **Common Equity Tier 1 (CET1) capital:** Comprises the highest quality capital, including common shares, stock surpluses, retained earnings, other comprehensive income, and minority interests in subsidiaries, absorbing losses on a going-concern basis. The Common Equity Tier 1 (CET1) capital ratio has a minimum requirement of 4.5% of RWAs.
- **Tier 1 capital:** Consists of CET1 plus additional Tier 1 capital, which includes loss-absorbing instruments like subordinated debt with no maturity and conversion or write-down mechanisms activated under specific conditions. The Tier 1 capital ratio has a minimum requirement of 6.0% of RWAs.
- **Tier 2 capital:** Subordinate to Tier 1 capital, this is supplementary capital and includes revaluation reserves, undisclosed reserves, hybrid instruments, and subordinated term debt used to absorb losses. Further, Tier 1 and 2 capital combined form the total capital ratio (Tier 1 + Tier 2 capital). Banks are generally subject to a minimum total capital ratio of 8.0% of RWAs.
- **Leverage ratio:** Ensures banks maintain a minimum level of capital relative to their total exposure profile. Leverage ratio is calculated by dividing its Tier 1 capital by its average total consolidated assets (quarterly average of total non-trading assets, adjusted for specific valuations and deductions), minus specific deductions from Tier 1 capital. The minimum leverage ratio requirement is 4.0%.



- **Supplementary leverage ratio:** A Category III institution as defined by the bank tailoring rules or an advanced approaches institution must determine its supplementary leverage ratio by dividing the institution's Tier 1 capital by its total leverage exposure. Total leverage exposure is the sum of the mean of on-balance-sheet assets and the mean of off-balance-sheet exposures minus applicable deductions. The minimum supplementary leverage ratio required is 3% with an enhanced supplementary leverage ratio (eSLR) of 5% applicable to US G-SIBs.
- **Additional buffers:** Banking regulators also subject banks to additional capital buffers designed to ensure safety and soundness in the banking system. The buffer amounts are based on macroeconomic conditions as well as bank-specific size and complexity. Examples of these include capital conservation buffer, countercyclical capital buffer, stress capital buffer, G-SIB surcharge, and systemic risk buffer.

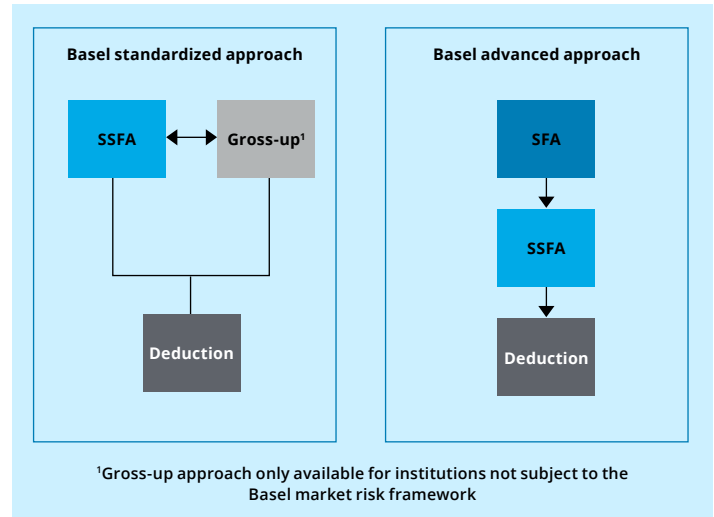
Risk-weighted assets (RWAs)

Under the existing US Basel rules, banks must use a hierarchy of approaches to calculate RWA for securitization exposures. The hierarchies and available RWA calculation approaches are specific to Basel standardized and advanced approaches as illustrated below:

- **Simplified supervisory formula approach (SSFA):** The SSFA framework is a non-modeled approach in which RWAs are derived using a supervisory prescribed formula requiring banks to furnish key input factors including seniority of the exposure, credit worthiness of the underlying collateral pool (as measured by delinquencies), and the specific type of asset class within the collateral pool.
- **Gross-up approach (standardized approach institutions):** The gross-up method for securitizations is a non-modeled approach, available to institutions not subject to market risk regulatory capital requirements, that allows financial institutions to calculate the risk weight of their securitization exposures by determining a credit-equivalent amount. This amount includes the institution's direct exposure plus an adjustment for senior tranches. The calculated risk weight is then applied to this amount to compute the RWAs.
- **Supervisory formula approach (SFA) (advanced approach institutions):** The SFA is a model-based approach that requires institutions to continuously calculate several key parameters, including the risk of underlying exposures, tranche characteristics, and credit enhancements. The RWA is calculated by applying a risk-based capital requirement, derived from these parameters, to a multiplier of 12.5. The SFA is particularly detailed, incorporating factors such as the capital requirement of underlying exposures, tranche thickness, and the level of credit enhancement to adjust the capital requirement based on the risk profile of the securitization exposure. This method offers a structured, yet complex, framework that allows institutions to reflect more accurately the risk characteristics of their securitized assets.

- **Deduction:** Institutions that are unable to calculate RWAs for securitization exposures using any of the above methods must assign such exposures a 1,250 percent RW.

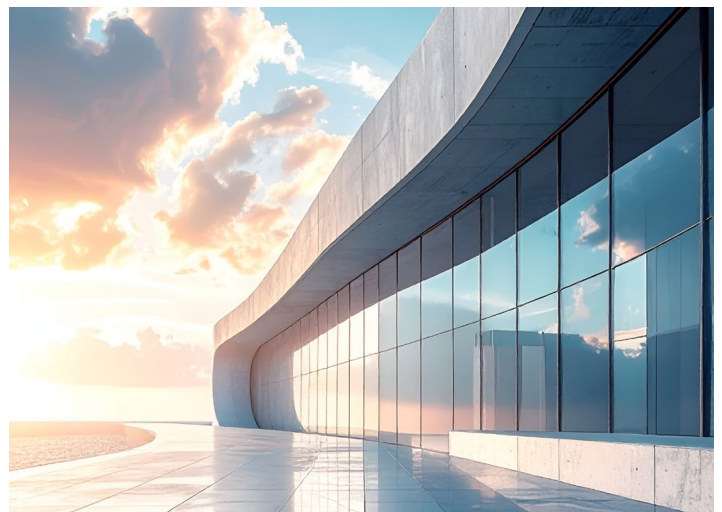
Basel securitization hierarchy of approaches



The hierarchy of approaches and specific frameworks listed above are covered in greater detail later in this chapter.

Basel regulatory capital requirements continue to evolve

Since the BCBS first introduced the Basel Accord in 1988, the framework has evolved globally with Basel II and Basel III introducing significant changes to all facets of the capital framework, including securitization regulatory capital requirements. The evolution continues with the recent US Basel III Endgame re-proposal. This section provides a high-level historical perspective on securitization capital treatment from Basel I to Basel III and a brief overview of the Basel III re-proposal, as it relates to securitizations.



Securitization capital rules: A historical perspective

- When Basel I was implemented in 1988, it did not have any securitization-specific provisions, but as the market grew, US regulators incorporated securitization-specific rules¹ in 2001.
- Basel II came into effect in 2007 in the United States and aimed for greater risk sensitivity and alignment of capital requirements with the underlying risk of an exposure.
- Basel III, finalized in 2013, introduced a number of key changes with respect to securitizations capital.

Basel I 1988

Basel Capital Accord

- “One-size-fits-all” approach with risk weights (RWs) assigned based on broad asset class designations
- Issuers treated securitized assets as off-balance sheet with no minimum capital requirements
- Securitization exposures in the banking book had RWs of 20% to 200%, based on external or internal ratings, or used a gross-up approach
- Basel I’s low-level exposure rule capped capital requirements at the maximum contractual exposure, with certain exposures attracting 1,250% RW

Basel II 2004

Revised Capital Framework

- The Basel II framework introduced significant complexity to securitization regulatory capital calculations
- Expanded definition of securitization exposures and introduced a new hierarchy of approaches: rating-based approach (RBA), internal assessment approach (IAA), supervisory formula approach (SFA) and deduction
- Both the RBA and IAA allowed banks to largely rely on external NRSRO-furnished ratings

Basel III 2009

Post-Financial Crisis Response

- US Basel III rules brought sweeping changes, including removal of reliance on external ratings (as a result of Dodd-Frank guidelines) and a sharp increase in risk-weight floor from 7% to 20%
- Introduction of a new hierarchy of approaches including Standardized and Advanced Approaches calculation methodologies (i.e., SSFA, SFA)
- Implemented more punitive measures for re-securitizations
- Further, elimination of FAS 166/167 under US GAAP resulted in significant consolidation of certain securitizations on to banks’ balance sheets

2026

US Basel III Endgame re-proposal

On March 19, 2026, the federal bank regulatory agencies issued three proposals (collectively, the “Proposals”) to revise the bank capital framework: (i) revisions to the risk-based capital framework for the largest, most internationally active and significant-trading firms (the “Basel III Enhanced Risk Based Approach Proposal”), (ii) revisions to the G-SIB capital add-on (the “GSIB Surcharge Proposal”), and (iii) revisions to the U.S. standardized approach for RWAs (the “Standardized Approach Proposal”) that, taken together, are intended to simplify and improve the risk sensitivity of capital requirements (e.g., better aligning minimum requirements with credit, operational, and market risks and considering interactions with the stress capital buffer). The newly proposed rules represent a significant scale-back from the initial US Basel III Endgame proposals released in July 2023, which would have resulted in measurably higher capital for large US banks.

By contrast, the newly released Proposals are expected to result in capital reduction for banks of all sizes while potentially also creating incentives for banks to consider re-entry or expansion of mortgage businesses given a more risk-sensitive framework. The Standardized Approach Proposal would largely retain the current standardized approach securitization framework while making a defined set of modifications intended to improve risk sensitivity and better address structural and counterparty risks embedded in securitizations.

Because the Proposals are subject to a 90-day public comment period (comments due June 18, 2026) and potential revision during finalization, the modifications below are framed as a high-level summary of the proposed direction.

¹ Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Capital Treatment of Recourse, Direct Credit Substitutes and Residual Interests in Asset Securitizations; Final Rules, November 29, 2001.

High level changes to securitizations regulatory treatment under the Proposals:

1. **Removal of SFA:** As part of the broader initiative to simplify capital rules and move away from advanced approaches constructs, the proposal would remove the existing SFA securitization RWA calculation;
2. **SSFA is replaced by SEC SA:** Adopt a new Securitization Standardized Approach (SEC SA) in place of SSFA, with revised definitions/inputs (e.g., attachment and detachment points, W, and KG) and specified supervisory floors; if a firm cannot (or elects not to) apply SEC SA due to insufficient data, the exposure is assigned a 1,250 percent RW;
3. **Elimination of gross-up approach:** Eliminate the gross-up approach that exists in the current capital rules; and
4. **Risk-weight floor changes:** Decrease from 20 percent to 15 percent RW for all securitization exposures (except resecuritizations, which have a RW floor increased to 100 percent).

Additionally, the Proposals overhaul securitization capital by tightening definitions and operational requirements (including synthetics and clean up calls), increasing conservatism for certain complex securitizations (resecuritizations, nth to default, certain derivatives, and CEIO strips), and providing more risk-sensitive approaches for certain exposures (e.g., overlapping exposures, senior "look through," and NPL securitizations). Much of this remaining chapter provides an in-depth look at the existing securitization regulatory capital requirements under the currently applicable frameworks in the United States and abroad.

Basel III impacts securitization transactions in multiple ways

Overall, Basel III increased the regulatory capital for most securitization exposures and introduced new due diligence requirements a bank must perform if it wishes to invest in securitizations.



Definition of securitization exposures

The broad regulatory definition of traditional securitizations,² introduced in Basel II and retained in Basel III with some modifications, is based on a set of criteria, including:

1. **Credit risk transfer:** Credit risk is transferred to third parties without using credit derivatives or guarantees.
2. **Tranching:** Credit risk is divided into multiple tranches with varying seniority levels.
3. **Performance dependency:** The success of the securitization depends on the performance of the underlying financial exposures.
4. **Nature of exposures:** The exposures involved are primarily financial and not owned by an operating company.
5. **Regulatory exclusions:** Certain setups, in which exposures are controlled by investment firms or held by specific investment entities like small business investment companies or SEC-registered funds, may not qualify as traditional securitizations based on their structure and risk characteristics.

Determining securitization exposure for regulatory capital is complex, focusing on the economic substance rather than legal form. Authorities can classify any economically supportive transaction as a securitization. The main criterion is the tranching of credit risk from underlying asset pools in a non-pro rata manner. Regulatory definitions exclude transactions with nonfinancial assets or recourse and include exposures to non-operating entities like hedge funds, diverging from industry norms. This has led to industry feedback and additional regulatory guidance³ on exposures to investment firms with significant asset control.

Operational criteria for originated securitizations

In addition to the securitization definition requirements, Basel III requires originating banks to satisfy the following four additional operational criteria to apply securitization treatment:

1. The exposures are not reported on the bank's consolidated balance sheet under GAAP.
2. The bank has transferred to one or more third parties' credit risk associated with the underlying exposures.
3. Any cleanup calls relating to the securitization are eligible cleanup calls defined under Basel III.
4. The securitization does not (a) include one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit, and (b) contain an early amortization provision.

² Synthetic securitizations definition is largely similar, except that tranching of credit risk occurs through the use of credit derivatives and/or guarantees instead of through the sale of assets. It also has specific operational criteria.

³ Federal Reserve Basel Coordination Committee (BCC) Bulletin 13-2: Excluding Exposures to Investment Firms from the Definition of "Traditional Securitization."

Failure to meet these four operational criteria requires a bank to hold regulatory capital on all the underlying assets of the originated transaction as if they had not been securitized.⁴

Criterion 4 was new under Basel III and applicable to many securitizations of revolving credit facilities (e.g., credit card receivables) containing provisions that require the securitization be wound down and investors repaid if the excess spread falls below a certain threshold. An early amortization event can increase a bank's capital requirements if new draws on the revolving credit facilities need to be financed by the bank using on-balance-sheet sources of funding.

Hierarchy of methodologies for securitization risk-based capital under Basel III

Securitization exposures are subject to a hierarchy of approaches for determining regulatory capital. As noted, the hierarchy of approaches changed under Basel III, including the elimination of the RBA available under Basel I and Basel II, as required by Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the introduction of SSFA. Under the advanced approaches, Basel III retained the SFA that was available under Basel II, and for the standardized approach (for non-market risk banks), retained the gross-up approach defined under Basel I.

Supervisory formula approach (SFA)

This approach is exclusively available to banks using the advanced approaches. The SFA is required over SSFA whenever sufficient data is available and is generally more risk-sensitive and can result in potentially lower capital requirements. It calculates capital requirements based on the capital estimate of the underlying asset pool as if held directly on the bank's balance sheet, adjusted for the tranche's degree of subordination.

SFA capital is based on the capital estimate of the underlying pool of assets as if held directly on the balance sheet, adjusted for the degree of subordination (i.e., loss absorbance by junior tranches) of a given tranche.

The SFA requires detailed pool- and tranche-level parameters and uses a supervisory formula to determine capital requirements.

Based on the above inputs, SFA uses a supervisory prescribed formula to calculate the capital requirement. It results in 1,250 percent RW for portions of the tranche with a subordination level below the K_{IRB} threshold and applies progressively lesser capital to more senior tranches above the K_{IRB} threshold, subject to a 20 percent RW floor.

Interestingly, SFA, as it requires the K_{IRB} calculation of the underlying pool of assets, is not eligible for transactions with any non-internal-

ratings-based underlying assets (i.e., not a wholesale, retail, equity, or securitization exposure as defined under Basel III). While under Basel II such transactions required deduction, they are now eligible for SSFA instead.

The implementation of SFA includes several hurdles associated with obtaining the transaction data for underlying pools and developing risk models. Supervisors have issued [guidance](#)⁵ to provide flexibility in the K_{IRB} calculation to circumvent data and modeling challenges.

Tranche-level parameters	
L	Credit enhancement level of the securitization exposure within the tranche structure
T	Thickness of the securitization exposure within the tranche structure
TP	Tranche percentage of the securitization exposure the bank owns
Pool-level parameters	
UE	Amount of the underlying exposures within the pool
K_{IRB}	Capital requirement of the underlying pool based on the advanced approaches <ul style="list-style-type: none"> This requires transaction data of the underlying pool of loans and also development of risk models to generate the risk parameters (i.e., probability of default and loss-given default)
EWALGD	Exposure-weighted average loss given default of the underlying pool
N	Effective number of exposures in the underlying pool

Simplified supervisory formula approach (SSFA)

The SSFA was newly introduced in Basel III and is available under both the standardized and advanced approaches. Under advanced approaches, SSFA is allowed only if SFA is not possible, while under standardized approaches, SSFA is the primary option, especially for Market Risk banks. Additionally, as per Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (commonly known as the Collins Amendment), advanced approach banks, if applying SFA for any transaction, will still need to calculate capital based on SSFA for that transaction for standardized approach capital floor calculation.

4 The criteria shown are for traditional securitizations; this differs for synthetic securitizations.

5 Federal Reserve BCC Bulletin 13-7: Implementing the Supervisory Formula Approach for Securitization Exposures and Federal Reserve BCC Bulletin 15-1: Supervisory Guidance for Implementation of the Simplified Supervisory Formula Approach for Securitization Exposures under the Advanced Approaches Risk-Based Capital Rule.

As the name indicates, SSFA uses a similar approach to SFA and is also based on the capital estimate of the underlying pool of assets as if held directly on the balance sheet, adjusted for the degree of subordination (i.e., loss absorbance by junior tranches) of a given tranche. It requires five pool-level and tranche-level parameters.

Tranche-level parameters	
A	Attachment point of securitization exposure within the tranche structure
D	Detachment point of securitization exposure within the tranche structure
Pool-level parameters	
K_G	Weighted average total capital requirement of the underlying pool based on the standardized approach
W	Ratio of delinquent exposures in the underlying pool
P	Supervisory calibration parameter (0.5 for securitizations and 1.5 for re-securitizations)

Similar to SFA, SSFA also results in 1,250 percent RW for portions of the tranche with a subordination level below the K_G threshold, and applies progressively lesser capital to more senior tranches above the K_G threshold, subject to the RW floor of 20 percent.

Gross-up approach

Non-market risk standardized approach banks also have the option of using the gross-up approach, instead of the SSFA, as long as it is applied across all securitization exposures. The gross-up approach, similar to Basel I, is also based on the subordination of the tranche and the RW applicable to the underlying pool of assets. It requires four inputs:

- Exposure amount
- Pro rata share (similar to tranche percentage in SFA)
- Enhanced amount: par value of all other senior tranches
- Average RW of the underlying pool of assets, as per the Basel III standardized approach (similar to K_G)

The final RWA is calculated by applying the average RW to the sum of the exposure amount plus pro rata share times the enhanced amount, subject to a RW floor of 20 percent.

1,250 percent RW

Securitization exposures to which none of these approaches can be applied must be assigned a 1,250 percent RW (i.e., 100 percent capital charge).

Exceptions and alternatives for specific exposure types

Gain-on-sale

This refers to an increase in equity capital resulting from a traditional securitization, other than an increase in equity capital resulting from the bank's receipt of cash in connection with the securitization or reporting of a mortgage servicing asset (MSA).

While Basel III retained the Basel I and Basel II approach of deduction for any after-tax gain-on-sales, the deduction is applied to CET1 instead of Tier 1, and also amends the definition to exclude MSA.

CEIO

This is an on-balance-sheet asset that in form or in substance: (1) represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization, and (2) exposes the holder of the CEIO to credit risk directly or indirectly associated with the underlying exposures that exceeds a pro rata share of the holder's claim on the underlying exposures, whether through subordination provisions or other credit-enhancement techniques.

Under Basel III, any portion of a CEIO that does not constitute a gain-on-sale attracts a 1,250 percent RW.

Senior purchased credit derivatives and non-credit derivatives with securitization SPE counterparties

Counterparty credit risk for such exposures is calculated using the securitization framework, as per the applicable hierarchy. However, an alternative option of 100 percent RW is also available. The 50 percent RW cap for derivatives under Basel I is no longer available.

Securitization due diligence requirements

Basel III imposed a new requirement around due diligence for all securitization transactions, which banks need to satisfy prior to acquiring and on an ongoing basis (no less frequently than quarterly). It requires a bank to demonstrate a comprehensive understanding of the features of the securitization that would materially affect the performance of the exposure (e.g., triggers, enhancements, and pool performance). The analysis is required to be commensurate with the complexity of the exposure and the materiality of the exposure in relation to capital.

Failure to comply with initial and ongoing due diligence requirements for any securitization exposures requires a 1,250 percent RW to be assigned to such exposures.

Certain asset-backed commercial paper exposures

This provides the option of applying the RW based on the highest RW applicable to any of the individual underlying exposures for eligible asset-backed commercial paper (ABCP) liquidity facilities and eligible second-loss position or better exposures to an ABCP.

Implicit support

In case a bank provides implicit support (i.e., support in excess of its contractual obligations), it must hold capital on the entire pool of underlying assets and is also subject to additional disclosure requirements.

IO RMBS

Like Basel I and Basel II, Basel III retained the 100 percent RW floor for IO RMBS strips.

Trust-preferred security collateralized debt obligations (TruPS CDOs)

TruPS CDOs are synthetic exposures to the capital of unconsolidated financial institutions and are subject to deduction from capital (i.e., significant and nonsignificant financial institution threshold deduction tests). Any amounts of TruPS CDOs that are not deducted are subject to the securitization treatment (unless treated as a covered fund under Section 619 of the Dodd-Frank Act, known informally as the Volcker Rule).

Credit risk mitigation (CRM) for securitization exposures

CRM methodology provides a capital benefit by recognizing certain collateral or guarantees/credit derivatives supporting securitization exposures. CRM is recognized for financial collateral, as per the “collateral haircut” approach.⁶ For eligible guarantees and eligible credit derivatives obtained from an eligible guarantor, CRM is recognized as per the borrower substitution approach rules. The definition of eligible guarantor was updated in Basel III to exclude insurance companies predominantly engaged in providing credit protection (i.e., monoline bond insurers), borrowers with positive correlation (i.e., wrong-way risk) with the guaranteed exposures, and entities without investment-grade unsecured long-term debt.

Securitization exposure amount calculation

The calculation of securitization exposure amounts for on-balance-sheet assets is aligned with GAAP principles (see [chapter 8](#)). Under Basel III, the method for determining the exposure amount of all AFS debt securities, including securitization exposures, has shifted to using fair value. This change eliminates the need for an AOCI adjustment previously required. However, Basel III offers an AOCI opt-out option for banks using the standardized approach. Banks

that choose to opt out can continue to calculate the exposure amount based on the book value, adhering to the methodologies established under Basel I and Basel II. This option provides flexibility for standardized approach banks in managing their AFS debt securities portfolio.

Exposure amounts for counterparty credit risk exposures with securitization SPE counterparties are calculated using the same approach as for other wholesale counterparties (i.e., primarily using the current exposure methodology [CEM]⁷ approach for derivatives). For sold credit derivatives, exposure amount is the full notional amount of protection provided, and for credit protection provided through an nth-to-default credit derivative, exposure amount is the largest notional amount of all the underlying exposures.

For other off-balance-sheet commitment amounts, exposure amount is generally set at the full notional amount.

- For an off-balance-sheet exposure to an ABCP program, such as an eligible ABCP liquidity facility, the notional amount may be reduced to the maximum potential amount that could be required to fund given the ABCP program’s current underlying assets (calculated without regard to the current credit quality of those assets).
- Exposure amount for eligible ABCP liquidity facilities for which SSFA does not apply is calculated by applying a credit conversion factor (CCF) of 50 percent to the notional amount, but the full notional amount (i.e., a CCF of 100 percent) is applicable for such facilities where SSFA is applied.
- For overlapping or duplicative facilities, duplicative capital is not required for the overlapping position. The applicable risk-based capital treatment that is applied is the one that results in the highest risk-based capital requirement.
- For facilities to all other customer SPEs, a reduction is not available, and the full notional amount is used to calculate exposure amount.

Eligible servicer cash advance facilities are required to hold risk-based capital against any funded advances, but not any future potential cash advances under the facility.

Ineligible servicer cash advance facilities must hold risk-based capital against both any funded advances and the amount of all potential future cash advance payments that it may be contractually required to provide during the subsequent 12-month period.

Subject to certain conditions, for small business obligations sold with recourse, exposure amount is calculated only for the contractual exposure.

6 Under the collateral haircut approach, exposure amount is determined based on the value of the exposure less the value of any financial collateral plus adjustments based on collateral type and any currency mismatch.

7 Under the CEM approach, exposure amount is the sum of a contract’s mark-to-market value plus a potential future exposure (PFE) amount. The PFE amount is calculated based on notional principal amount and a conversion factor determined based on the type of derivative contract and remaining maturity.

Definition and treatment of re-securitizations

Re-securitization refers to a securitization that has more than one underlying exposure, in which one or more of the underlying exposures is a securitization exposure. Basel III modified the definition from Basel II to exclude re-tranching of a single securitization exposure (e.g., RE-REMIC).

The RWA calculation for re-securitizations is subject to the same hierarchy of approaches (i.e., SFA and SSFA) and requires a look-through approach to the ultimate underlying pool supporting the underlying securitization position.

Re-securitization exposures generally attract higher capital under both SFA and SSFA. For example, SFA requires the EWALGD input be set to 100 percent, and SSFA requires the parameter P input be set to 1.5 for all re-securitizations. Additionally, re-securitizations are ineligible as financial collateral.

Treatment of securitization exposures under the market risk framework

As noted earlier, the market risk framework applies only to the market risk banks (banks with trading assets in excess of \$1 billion, or 10 percent of total assets). The market risk framework-related changes in Basel III (sometimes referred to as Basel 2.5) have been effective since January 1, 2013.

Basel III introduced multiple changes aimed at an overall increase of market risk capital in the trading book, with a focus on securitizations. In particular, Basel III imposed due diligence requirements and also, outside of the correlation trading portfolio, increased the specific risk add-on to be equal to the banking book credit RWA charges (i.e., as per SSFA and SFA), as applicable. Also, Basel III strengthened the eligibility criteria for market risk covered treatment, such that certain trading book portfolios are no longer eligible for market risk treatment.⁸

For market risk covered correlation trading portfolio positions, an internally modeled approach is allowed but with strict qualification criteria. Thus, securitization exposures in the trading book now receive an equal number of governance requirements and, in most cases, higher capital than similar exposures in the banking book.

The BCBS published a revised international standard for market risk in January 2016 known as the fundamental review of the trading book (FRTB). Section "[Fundamental review of the trading book](#)" discusses in more detail the FRTB impact on the securitization exposures treatment, including the impact of the updated trading book/banking book definition and the new market risk capital charge calculation approach.

BCBS revisions to securitization framework

Since the publication of the Basel III international capital framework, the BCBS has revised various aspects of the rules, including those related to the standardized approach for credit risk, counterparty credit risk, Market Risk (as mentioned in the previous section), and the securitization framework. Certain significant enhancements to the Basel securitization framework were finalized internationally by the BCBS with an effective date of January 1, 2018. Overall, the changes to the international framework make it more aligned with the existing US rules. However, there will continue to be certain divergences in capital charges for similar securitization exposures across jurisdictions (such as between the United States and European Union [EU]).

The revised set of calculation approaches and hierarchy per the new BCBS securitization framework is discussed below:

Internal ratings-based approach (SEC-IRBA)

This approach exists at the top of the hierarchy and is analogous to the existing SFA approach, but with certain modifications. In addition to the input parameters required by SFA (K_{IRB} , A, D, EWALGD, etc.), the new methodology also requires effective maturity (Mt), defined as either the cash flow-weighted average maturity or 80 percent of the remaining contractual maturity.

Based on the above inputs, a supervisory prescribed formula is used to calculate the RWA with a RW floor of 15 percent. The SEC-IRBA approach can be applied only if the bank is able to calculate K_{IRB} for at least 95 percent of the underlying assets.

External ratings-based approach (SEC-ERBA)

The revised international framework retains the external rating approaches (RBA, inferred RBA, and IAA). However, to better align with jurisdictional differences, especially given that it is disallowed in the United States under Basel III rules, the SEC-ERBA approach is required only in jurisdictions that allow external ratings.

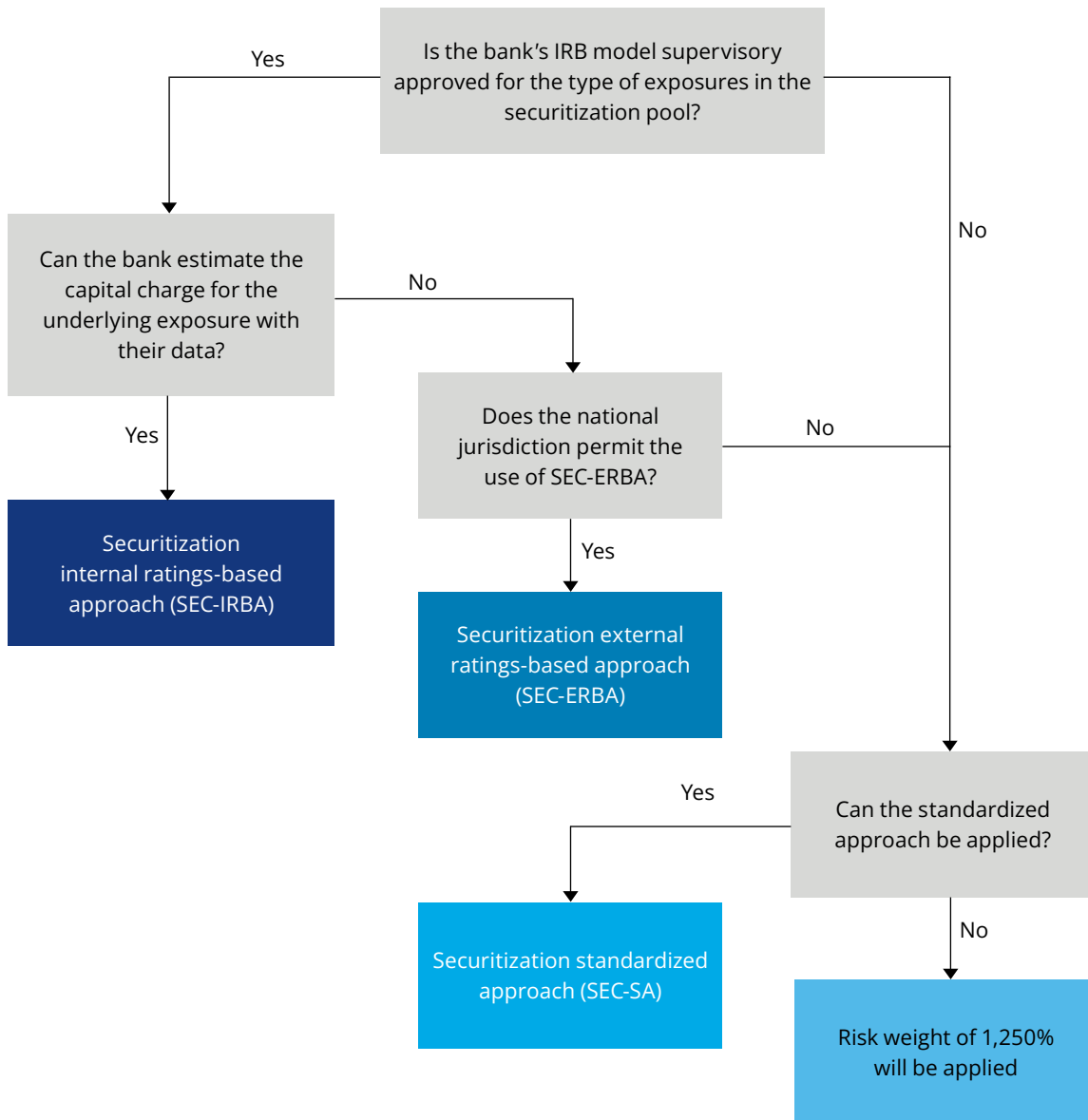
Standardized approach (SEC-SA)

In general, this is analogous to the US Basel III SSFA approach, but with a RW floor of 15 percent. If the delinquency status is unknown for no more than 5 percent of the underlying pool, an adjustment factor applies, beyond which the exposure will attract 1,250 percent RW.

⁸ Basel 2.5 and Basel III market risk framework revisions restrict the applicability of market risk treatment to exposures with "trading intent" regardless of trading or banking book classification from an accounting perspective.



The below flowchart could be used for determining the hierarchy of approaches to be used:



Securitization exposures within the Basel III leverage ratios

There is already a leverage ratio requirement as part of Basel I, which was retained under Basel III, defined as the ratio of Tier 1 capital to total on-balance-sheet assets.⁹ Additionally, the Basel III advanced approach also includes a supplementary leverage ratio requirement, which is similar to the leverage ratio but also includes a measure for off-balance-sheet assets.

Both leverage ratios require total on-balance-sheet assets to be measured as per GAAP, or any other accounting framework no less stringent than GAAP. Accordingly, all exposures that are consolidated as per ASC 810 are included. For off-balance-sheet commitments, 10 percent of the notional amount is used only for unconditionally

cancelable commitments; otherwise, the full notional amount is used as the off-balance-sheet measure. For derivatives, the CEM approach, as defined in the Basel III capital requirements, is used to calculate the exposure amount.

Securitization exposures within the Basel III liquidity ratios

Basel III also introduced measures to strengthen the liquidity profile of the banking sector. Liquidity ratio requirements comprise two ratios: the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The LCR promotes the short-term resilience of a bank's liquidity profile, and the NSFR requires banks to maintain a stable funding profile in relation to its activities over a longer period.

⁹ Less assets deducted from Tier 1 capital.

The US LCR rule requires covered banks to maintain minimum amounts of high-quality liquid assets (HQLA) to withstand cash outflows over a 30-day horizon. The LCR final rule mandates a minimum LCR ratio of 100 percent for financial institutions with more than \$50 billion in assets. However, the smaller banks covered by the rule that are not “Basel Advanced Approach” banks are subject to a less-stringent modified LCR rule.

$$\text{LCR: } \frac{\text{Stock of HQLA}}{\text{Net cash outflows over a 30-day stress period}} \geq 100\%$$

Assets eligible for HQLA treatment, which are included in the numerator of the LCR, encompass government securities, investment-grade corporate bonds, and agency mortgage-backed securities (MBS). There are slight variations in the definition of HQLA between international standards set by the BCBS and US regulations, notably that private-label securitizations are not recognized as HQLAs in the United States.

HQLAs are categorized into three levels based on asset quality and associated risks: Level 1, Level 2A, and Level 2B. Each level has specific haircuts and limitations on the proportion that can contribute to the LCR numerator. From an LCR standpoint, securities from Fannie Mae and Freddie Mac that qualify as Level 2A HQLAs, and Ginnie Mae securities that qualify as Level 1 HQLAs, are more advantageous compared to private-label securitization holdings.

The LCR denominator is calculated based on expected net cash outflows over a 30-day stress period, particularly concerning securitizations:

- **100% outflow rate:** Assigned to undrawn liquidity or credit enhancement facilities for SPEs issuing commercial paper or securities.
- **Variable outflow rates (10% to 100%):** Applied to undrawn facilities for SPEs that are consolidated subsidiaries, depending on the facility type and consolidating counterparty.
- **Greater outflow requirement:** For banks sponsoring structured transactions with non-consolidated issuing entities, the outflow is the greater of the entity's total maturing obligations and commitments within 30 days, or the maximum potential funding the bank could provide in that period.
- **100% outflow rate for other SPE facilities:** Applies to undrawn amounts related to other unspecified facilities to SPEs. The NSFR measures liquidity risk over a longer time period, which extends to one year.

$$\text{NSFR: } \frac{\text{Available amount of stable funding (ASF)}}{\text{Required amount of stable funding (RSF)}} \geq 100\%$$

Per the international framework finalized by the BCBS, a 50 percent required amount of stable funding (RSF) factor has been assigned to RMBS securities with a credit rating of at least AA. Assets with greater RSF factor tend to reduce the NSFR and are likely to be less desirable from a liquidity perspective.

The inclusion of securitization exposures in the NSFR calculation hinges on whether the securitization vehicle is consolidated into the balance sheet of the reporting entity, which is determined by whether the entity holds a controlling interest. For securities issued by a consolidated securitization vehicle:

- **ASF factors:** These securities, which appear as liabilities on the consolidated balance sheet, are assigned an available stable funding (ASF) factor of either 100% or 50%, depending on their effective maturities.
- **RSF factors:** The encumbered assets used as underlying for these securities are assigned a required stable funding (RSF) factor of either 100% or 50%, based on the period of encumbrance.

Fundamental review of the trading book (FRTB)

The BCBS conducted a FRTB post-financial crisis, culminating in a more robust framework established in January 2019 to set minimum capital requirements for market risk. Although the BCBS has finalized these standards, they have not yet been implemented in the United States. The new market risk framework introduced three significant enhancements:

First, it more clearly defined the boundary between the trading book and the banking book to prevent regulatory arbitrage through the shifting of positions between books.

Second, the framework introduced a comprehensive standardized approach for calculating the overall capital charge, which includes: a) the sensitivities-based method (SbM), aggregating delta, vega, and

- 1996** First framework for minimum capital requirements for market risk
- 2009** Basel 2.5 reforms
- 2016** Revised market risk framework
- 2026–2027** FRTB go-live (EU, UK)



curvature sensitivities across seven risk classes to estimate potential losses under stress scenarios; b) the default risk capital charge (DRC), which accounts for the jump-to-default risk associated with credit-sensitive instruments; and c) the residual risk add-on (RRAO), designed to cover capital requirements for risks not captured by the SbM or DRC.

Third, the framework enhanced the internal models approach by replacing value-at-risk (VaR) with the expected shortfall (ES) method as ES captures the tail risks, which are not accounted for in VaR. Under the finalized framework, the risk factors are classified across five liquidity horizon categories, ranging from 10 days to 120 days instead of a uniform 10-day horizon. ES is calculated at a 10-day liquidity horizon and extrapolated to appropriate liquidity horizon.

FRTB implementation imposes a significantly higher market risk capital requirement, implementation cost, and ongoing operational maintenance cost, all of which may potentially impact securitization market-making activity.

Other regulatory considerations impacting securitizations

Apart from the regulations discussed above, which directly affect capital, there are a variety of regulations that have an impact on the overall securitization industry, while indirectly affecting risk management and capital requirements.

Significant risk transfers

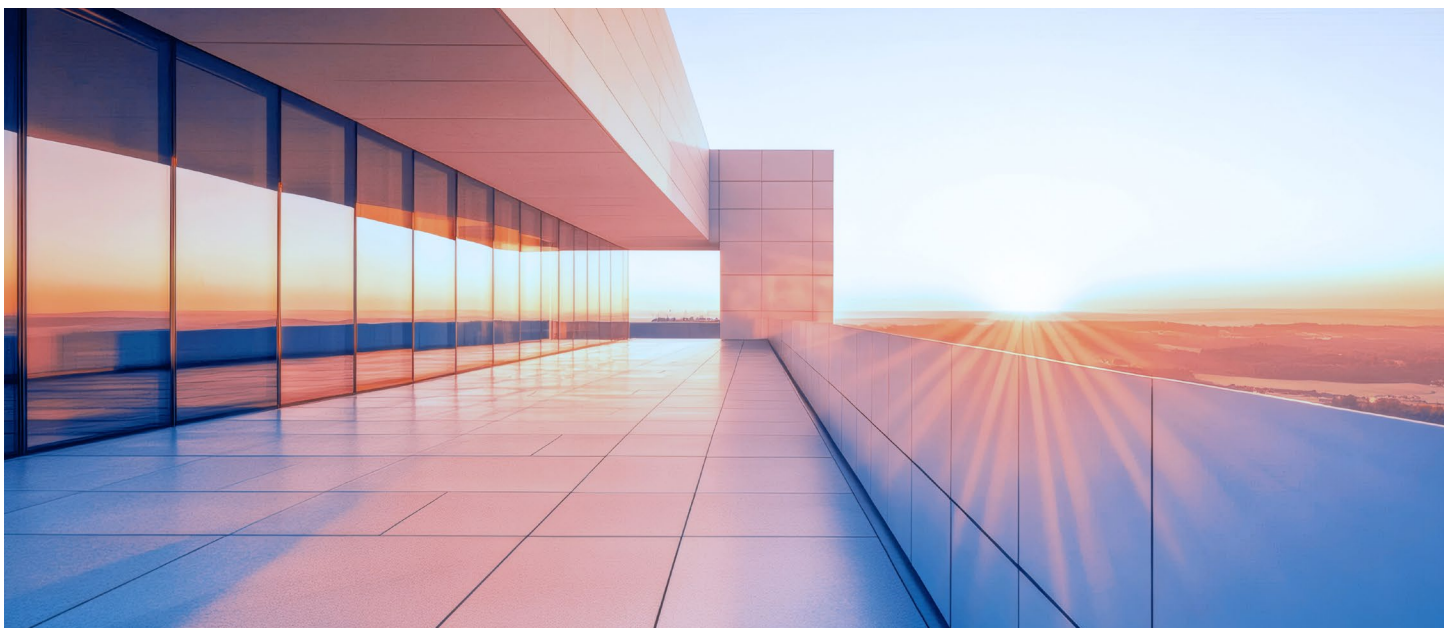
Ongoing regulatory capital reforms have led to banks facing increased capital requirements. Banks have addressed these pressures, in part, by leaning more heavily on synthetic securitization¹⁰ structures. One prominent example is significant risk transfers (SRTs), that a number of banks have utilized to reduce

regulatory capital charges while also managing balance sheets. Under existing US Basel rules, banks can lower potential loss exposure on the loans and, in turn, reduce regulatory capital charges through creative deal structuring.

While US regulators have historically been conservative in approving bank requests to use synthetic risk transfers (especially after the 2008 financial crisis), they have begun to signal a slight change in their stance recently. In September 2023, the Federal Reserve ("Fed") allowed regulatory capital relief for a credit-linked note (CLN) at a US bank. Additionally, the Fed published limited guidance on SRTs in an FAQ, with some high-level criteria and a process for banks to seek Fed approval for capital relief.

The Federal Reserve's FAQ on SRT transactions outlines the treatment of CLNs under the capital rule:

- **Synthetic securitizations:** Banks can recognize credit risk mitigation for collateral on the reference portfolio under synthetic securitization rules if they meet specific regulatory criteria and the definition of a "synthetic securitization."
- **Direct issuance of CLNs:** Directly issued CLNs often do not qualify as synthetic securitizations because they may not use standard industry documentation or recognized credit risk mitigants, like collateral. For a synthetic securitization to be recognized, it must include a guarantee or a credit derivative executed under standard industry documentation. Direct CLNs often do not meet this requirement. Additionally, financial collateral implies a security interest, but the cash for direct CLNs is owned by the note issuer, not held as collateral. Therefore, Federal Reserve-regulated institutions may not automatically recognize these transactions as synthetic securitizations under regulatory capital rules.



¹⁰ Basel rules define synthetic securitizations as an on-balance-sheet tranching of credit risk achieved through the use of credit derivatives and/or guarantees.

Risk retention rules

Risk retention rules finalized by the US regulators generally require the sponsors¹¹ of ABS to retain at least 5 percent credit interest in these transactions. These rules are intended to align the interest of the sponsors to the interest of the investors by ensuring that the sponsors maintain "skin in the game" and curb the "originate to distribute" model (whereby loans are originated with the sole purpose of offloading them into securitization pools, thus reducing incentive to maintain high underwriting and credit quality standards). On the other hand, the rule also permits an exemption from risk retention when the securitization pool contains particular types of underlying assets and is subject to conditions that enable prudent underwriting standards.

The rule prescribes the following standard options to retain credit risk:

Eligible horizontal interest retention

Under this option, the sponsor must retain at least 5 percent of economic interest in the credit risk of the first to default or first loss tranche of the securitization pool. The tranche has to have the most subordinate claim to any principal and interest payments and absorbs losses resulting from any shortfalls before any other interests in the pool. The 5 percent interest is measured using the GAAP fair value measurement framework, and additional disclosures are required related to the fair value calculation method employed.

Eligible vertical interest retention

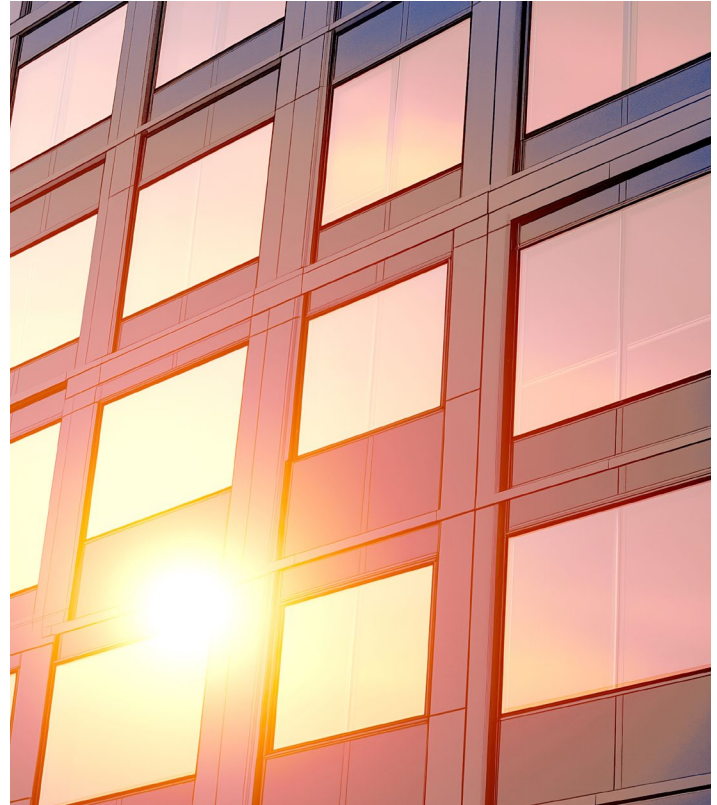
Under this option, the sponsor must retain at least 5 percent of economic interest in the credit risk across all the tranches of the securitization pool. The rule requires the sponsor to hold a proportional interest in each tranche of the pool to achieve the 5 percent. However, unlike the horizontal risk retention option, fair value measurement is not mandatory.

Hybrid interest retention

The rule also allows the sponsor to meet the requirements by retaining a combination of the horizontal and vertical interests, provided that the combination adds up to at least 5 percent. However, the rule does not specify separate minimums for either the horizontal or vertical interest that a sponsor should hold when opting for the hybrid interest retention.

Eligible horizontal cash reserve account

The sponsor may also meet the risk retention requirement by establishing an eligible horizontal cash reserve account in an amount equal to 5 percent of the securitized assets. The account has to be held by a trustee and may only be composed of cash and cash equivalents. The use of these funds is severely restricted by rule, but they can be used to absorb losses, similar to an eligible horizontal tranche.



Outside the standard retention options defined above, the sponsor can also employ alternative ways to satisfy the risk retention requirements specific to certain asset class categories (provided certain conditions are met).

The rule specifies a number of exemptions related to different categories of qualifying underlying assets, which would not require sponsors to retain the 5 percent. For example, the rule specifies that the sponsor is not required to retain any risk in securitization pools that are solely composed of qualified residential mortgages, as defined by the Consumer Financial Protection Bureau (CFPB) under the Truth in Lending Act. In case of a blended pool of qualifying residential mortgages and other assets, the risk retention requirements can be prorated and reduced to 2.5 percent of the total securitization pool.

Additionally, Ginnie Mae transactions are also fully exempt from risk retention requirements because such transactions are federally insured or guaranteed. Similarly, Fannie Mae and Freddie Mac transactions can also satisfy risk retention requirements by guaranteeing interest and principal payments on the investor interests, as long as they continue to operate under conservatorship.

¹¹ Risk retention is required by either the sponsor or the depositor (if the depositor is not the sponsor).

The Volcker Rule

The [Volcker Rule](#) restrictions generally exempt securitization activities but classify some securitization vehicles (CDOs and CLOs that are not solely composed of loans) as “covered funds,” which are then subject to strict de minimis limits and punitive capital treatment (i.e., deduction from Tier 1 capital). Grandfathering exemptions are allowed for TruPS CDOs issued before May 19, 2010, by BHCs less than \$15 billion in size, or by mutual holding companies that were acquired by a bank on or prior to December 10, 2013.

Single-counterparty credit limit (SCCL)

In May 2018, the Federal Reserve issued the SCCL final rule to establish single-counterparty credit limits for covered large US bank holding companies, foreign banking organizations, and intermediate holding companies. Per the final rule, no covered company may have an aggregate net credit exposure to any counterparty that exceeds 25 percent of the Tier 1 capital of the covered company, and no major covered company (G-SIB) may have aggregate net credit exposure to any major counterparty that exceeds 15 percent of the Tier 1 capital of the major covered company.

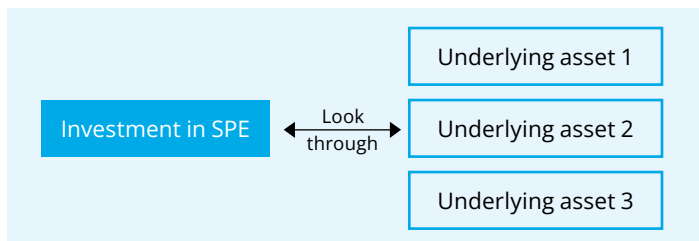
$$\text{SCCL ratio} = \frac{\text{Net credit exposure to a counterparty group}}{\text{Tier 1 capital}}$$

In order to compute single-counterparty exposures due to securitization exposures, a look-through approach is prescribed. The approach measures the bank’s exposure to each issuer of assets in the SPE. This regulation mandates banks to monitor their gross credit exposures to the single unaffiliated counterparties due to securitization more closely. It requires banks to have detailed data available on underlying assets and issuers of those assets in the SPE.

Securitization exposure calculation for underlying issuers

For each securitization exposure, a bank must determine whether the amount of its gross credit exposure to an issuer of assets in an SPE, due to an SPE exposure, is equal to or greater than 0.25 percent of the bank’s Tier 1 capital using either one of the following two methods:

- 1) The sum of all the issuer’s assets in the SPE; or
- 2) The application of the look-through approach.



If the amount of its gross credit exposure to an issuer of assets in an SPE is less than 0.25 percent of the bank’s Tier 1 capital, the amount of gross credit exposure to that issuer may be attributed to either that issuer of assets or the SPE. If the bank determines its gross credit exposure to an issuer of assets in an SPE to be 0.25 percent or more of its Tier 1 capital, a look-through approach is applied, in which the gross credit exposure with respect to an issuer of assets is calculated per the rank of investors.

A bank must also recognize the gross credit exposure to a third party that has a contractual obligation to provide credit or liquidity support to an SPE whose failure or material financial distress would cause a loss in the value of the covered company’s SPE exposure.

The issuer of assets in the SPE must be then identified as a counterparty, and the gross credit exposures must be aggregated with any other gross credit exposures to that same counterparty prior to reporting.

FR 2590 reporting of securitization exposures

For its top 50 counterparties, banks are required to submit the exposures in all SPEs in an FR 2590 quarterly report. Schedule G reports securitization exposures arising from the look-through approach. Gross credit exposure to a securitization that does not require application of the look-through approach is reported as either debt securities or investment equity securities, as applicable.

Securitization exposure is defined in the rule as an investment in the debt or equity of an SPE, or a credit derivative or equity derivative between the covered company and a third party where the covered company is the protection provider and the reference asset is an obligation or equity security of, or equity investment in, an SPE.

“Covered companies” are defined as any US G-SIB and any BHC that has \$250 billion or more in total consolidated assets.

FR 2590 Top 50 counterparties reporting form contents

- Schedule G Gross Credit Exposures
- Summary of Net Credit Exposure

FDIC Safe Harbor Rule

The FDIC’s Securitization Safe Harbor Rule establishes conditions under which the FDIC, as receiver or conservator, will refrain from using its authority to repudiate contracts to reclaim or recover financial assets transferred in securitization transactions. The rule protects both grandfathered transactions (those completed on or before December 31, 2010, that met previous GAAP conditions) and more recent transactions that comply with post-November 15, 2009, GAAP conditions for sale accounting treatment. The rule aims to enhance transparency and reduce risks in securitization, particularly addressing issues from the 2008 financial crisis by requiring detailed disclosures and compliance with stringent conditions to qualify for safe harbor protection.

In 2020, the FDIC amended the rule, primarily to ease certain disclosure requirements under Regulation AB when it is not applicable to the transaction. This amendment was intended to encourage more insured depository institution (IDI) participation in securitizations by making the compliance process less burdensome while still maintaining the necessary transparency and integrity of securitization practices. This amendment reflects an ongoing effort to balance regulatory oversight with the facilitation of securitization activities that support the broader financial system.

EU updates

On January 1, 2019, the European Union introduced a comprehensive securitization framework through two key regulations: Regulation (EU) 2017/2402 (the Securitization Regulation) and Regulation (EU) 2017/2401 (the Securitization Prudential Regulation [SPR]). These regulations allow for legacy securitizations to be grandfathered, yet still eligible for the simple, transparent, and standardized (STS) designation, contingent on adherence to new standards concerning transparency, risk retention, and other requirements. The [STS criteria](#) are closely aligned with the simple, transparent, and comparable (STC) criteria defined by BCBS and, designed to aid stakeholders in assessing securitization risks and returns effectively. These criteria emphasize simplicity in asset and structure characteristics, transparency through detailed disclosures, and comparability across securitizations, enhancing risk assessment capabilities.

The framework also introduced a revised hierarchy for calculating risk-weighted exposure amounts, favoring supervisory formula-based methods over external credit ratings, and explicitly prohibits re-securitizations with limited exceptions. It extended the responsibility of ensuring a 5 percent risk retention beyond just institutional investors to include a broader range of regulated entities like pension funds and insurers.

Additionally, the framework delineated eligibility for the STS designation, distinguishing between long-term and short-term securitizations. Although synthetic securitizations were initially ineligible for the STS label, on April 9, 2021, the STS framework was expanded to include on-balance-sheet (synthetic) securitizations. The final STS guidelines for on-balance-sheet securitizations were published by the European Banking Authority (EBA) on May 27, 2024.

Additionally, the EBA published a [report](#) in June 2022 proposing a dedicated framework for sustainable securitization, focusing on specialized disclosures and due diligence to foster growth in the EU's sustainable securitization market.

Regulatory capital considerations will continue to exert pressure

The pace of regulatory reform continues to force banks to evolve their overall strategy and operating model to ensure long-term sustainability while meeting regulatory expectations. In general, regulatory capital remains an area in which banks, and other market participants, will have to continue to navigate carefully.

While regulatory reform has created competitive disadvantages for banks relative to their nonbank financial institution (NBFI) peers, it has also led to growth in the bank–NBFI nexus. Ultimately, the evolution and expansion of the financial marketplace is likely to continue in response to ever-changing regulatory requirements and competitive pressures alike.



Contacts



Authors

Lakshmanan (Bala) Balachander

Consulting Services Principal | Deloitte & Touche LLP
+1 212 436 5340
lbalachander@deloitte.com

William Fellows

Audit & Assurance Partner | Deloitte & Touche LLP
+1 718 508 6888
wfellows@deloitte.com

Michelle Markowitz

Tax Managing Director | Deloitte Tax LLP
+1 713 982 4265
mmarkowitz@deloitte.com

Rishin Pandya

Consulting Services Managing Director | Deloitte & Touche LLP
+1 312 486 7585
ripandya@deloitte.com

Andrew Pidgeon

Audit & Assurance Partner | Deloitte & Touche LLP
+1 415 783 6426
apidgeon@deloitte.com

Greg Sobreiro

Audit & Assurance Managing Director | Deloitte & Touche LLP
+1 212 436 2487
gsobreiro@deloitte.com

Contributors

In memoriam:

James Cahalan

Managing Director | Deloitte & Touche LLP

Cara Bhalla

Audit & Assurance Senior Manager | Deloitte & Touche LLP
+1 703 251 1475
cbhalla@deloitte.com

Christy Bihm

Audit & Assurance Managing Director | Deloitte & Touche LLP
+1 203 761 3110
cbihm@deloitte.com

Elisa Esposito

Audit & Assurance Managing Director | Deloitte & Touche LLP
+1 212 436 4216
eesposito@deloitte.com

Aadarsh Malayil

Consulting Services Senior Consultant | Deloitte & Touche LLP
+1 212 436 4570
amalayil@deloitte.com

Christie Murphy

External Communications QRM Support Specialist Manager |
Deloitte & Touche LLP
+1 313 394 5017
christimurphy@deloitte.com



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