

March 15, 2013

Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Dear Basel Committee members:

**Re: CBA¹ Comments on consultative document:
“Revisions to the Basel Securitisation Framework”**

We appreciate the opportunity to review the Basel Committee's consultative document, *Revisions to the Basel Securitisation Framework* dated December 18, 2012. We recognize that the paper builds on the July 2009 *Enhancements to the Basel II Framework*, which addressed concerns on re-securitizations. We understand that with this paper the Basel Committee is seeking industry feedback on key elements of the proposed changes to the capital requirements for securitizations, as well as the reliance on external ratings, and that it will conduct a quantitative impact study (QIS) of the proposals before deciding on a definitive way forward.

We have provided our comments on some key issues below, and offer a more detailed response on the consultative draft and its 24 questions in the attached appendix. Overall, we are concerned with the unintended negative consequences that the proposed rules will have on the financial market. We also believe that the calibration of the proposed approaches fail to produce capital requirements that are commensurate with the actual risk of the securitization exposures. This is particularly evident with the proposed capital floor level and maturity adjustment, which significantly increase capital charges on longer-dated, senior high quality exposures. In addition to describing some of our reservations, the following also proposes a number of recommendations that we believe can better assist the Basel Committee achieve its stated objectives of the new framework.

¹ The Canadian Bankers Association works on behalf of 55 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 274,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

Market Impact

The proposed rules will cause banks, as investors of these securities, to demand a higher yield to achieve an adequate return from the higher capital requirements. In response, two possibilities can ensue:

1. If the issuers do not increase the yield on their issued securities, then banks, as investors, will be forced to significantly reduce their exposure to senior high-quality asset-backed securities (ABS) and fill the void with riskier whole loan purchases. The ABS will instead be held by unregulated funds, who can price the risk more economically. This result would be yet another example of how more punitive capital rules have the unintended consequence of motivating banks to hold riskier assets and for safer assets to flow away from regulated financial institutions and into the unregulated shadow banking system.
2. If banks, as issuers, have to increase yields on ABS to meet demand, they will likely reduce the use of securitization as a funding vehicle. Instead, banks will be pushed to be more reliant on the unsecured wholesale debt market as a funding channel. As a result, banks will have a less diversified funding base and be more highly levered, thereby creating greater riskiness to the overall financial system.

In addition, as a result of the maturity adjustment factor, the proposed rules will cause the maturity terms offered for ABS to be shorter. Shorter maturity terms will increase liquidity and refinancing risk for banks, as issuers, and will increase reinvestment risk for banks, as investors. These increased risks can lead to a less stable financial market. Finally, the proposed rules will increase the program fees for Asset-Backed Commercial Paper (ABCP) conduits, thereby further precluding smaller issuers from participating in this market and increasing their funding costs.

Excessive Conservatism and Interplay with other Basel Proposals

We would recommend that, in its calibration, the Basel Committee consider other elements of Basel III that increase the quantity (e.g. high minimum capital ratios) and the quality (e.g. focus on common equity) of the capital that banks are required to hold. We believe that the substantial increase in risk weights for securitization exposures of very high quality, on its own and in aggregate with other measures taken to date, is excessive and results in multiple layers of conservatism.

Moreover, in setting the risk weights on the most senior high-quality exposures (including the maturity scaling), we also recommend that the Basel Committee consider the funded capital support provided by the banks' clients. As currently proposed, banks would be able to more cost-effectively finance client assets through purchasing the assets outright without the benefit of the paid-in capital support provided by clients in existing securitization structures. This is neither risk-sensitive nor prudent.

In addition, we recommend that the Basel Committee assess the interplay between the leverage ratio and incentives for securitization. We believe that the existence of a leverage measure provides a natural constraint on securitization and provides yet another example of how the proposals, as written, ignored the progress made elsewhere in prudential regulation.

Floors and Maturity Scale

We believe that the proposed capital floor level (i.e. 20% risk-weight, 58% risk-weight for 5-year maturities) is excessively high and does not reflect the credit experience of the securitization business performed in Canada. Scaling capital risk weights without regard to asset type, performance history, pool characteristics, service quality, and experience or geographic location seems inconsistent with the Basel Committee's stated objective of increasing the risk sensitivity of the securitization framework. As all types of securitization businesses are being treated as if they were all the same quality, we believe that banks' highly rated high-quality senior exposures are being unfairly treated with such floors and maturity scaling. Indeed, the proposed capital floor would eliminate the capital savings from securitization, effectively giving no credit to the bank for transferring away risk. Surprisingly, a single mortgage loan will attract in most banks, relatively speaking, less capital than a diversified portfolio of mortgage loans. We therefore recommend maintaining the minimum risk weights currently in place, which has been universally demonstrated to be sufficiently conservative in light of the actual performance experienced with the asset pools funded in Canada. We believe that the calibration of the floor should be carefully reviewed based on the results of the QIS.

Maturity Adjustment

While we theoretically support including a maturity adjustment to the securitization framework as an explicit driver for credit risk capital requirements, we firmly believe there should be design and calibration consistency between the revised framework and the overall Basel Accord. Since the Internal ratings-based (IRB) model does not consider a maturity adjustment when determining capital requirements for retail assets, we believe there should also be no maturity adjustment on securitization exposures that have underlying retail assets calculated under the IRB method by the bank. Further, we do not believe that approaches that utilize IRB capital requirements for the underlying pool of securitized assets (K_{IRB}) (e.g. Modified Supervisory Formula Approach (MSFA)) should have a maturity adjustment since K_{IRB} , by definition, already incorporates a maturity adjustment, and so layering another adjustment would result in double counting.

In our view the maturity applied should be consistent with the commitment of the credit provider, the nature of the underlying assets, and the tranche maturity, giving some credit for the seniority of the exposures. However, maturity scaling applied on top of base 1-year risk weights, which are already disproportionately high relative to the risk implied by the experience of banks in the Canadian funding markets, adds little to the achievement of risk sensitivity and prudence in the framework.

The proposal specifies that the maturity is based on the weighted average contractual cash flows of the tranche. We believe that a more appropriate definition of maturity would be the weighted average life of the tranche. Under this recommended definition, the expected prepayment and default of the underlying portfolio, as well as the cleanup call, would be reflected in the maturity calculation. Further, this recommended definition would be consistent with how maturity is calculated in pricing public ABS, the hedging of fixed rate structures, and Basel II Pillar 3 disclosure requirements. Should this recommended definition of maturity be accepted, we request that, at the very least, the maturity definition reflect the "minimum/core" prepayment that exists regardless of the market conditions.

Finally, the calibration of the proposed maturity adjustment appears to be overly punitive, especially for the MSFA approach. For example, the IRB risk-weight difference between a 1-year maturity and a 5-year maturity exposure outside the securitization framework is much smaller than if the assets were held in a securitization framework (i.e. given the longer maturity, we

estimate that the capital requirements increase by a factor of approximately 2 outside the securitization framework, while inside the securitization framework it could be as high as 9). We agree that the calibration of risk-weights should be risk sensitive and should be consistent with the IRB whole loan framework. However, this does not appear to be the case as capital requirements under the proposed framework are considerably higher by several multiples than they are under the existing framework.

Calibration

We believe that the highest ranking tranches in Canadian retail securitizations are being penalized due to the loss experience exhibited by some asset classes (e.g. subprime Residential Mortgage-Backed Securities (RMBS) and structured finance exposures such as re-securitization), which were originated and structured in other jurisdictions. These asset classes comprise 80% of global structured finance losses, but only 30% of global issuance from 2000 – 2011². This is evidenced in the Revised Ratings Based Approach (Revised RBA) where the risk weight for 5-year AAA-rated senior tranches increased from 7% to 58%.

Based on our preliminary analysis of the QIS exercise, we have observed a material misalignment between the results and the objectives of the revised framework. The calibration of the new approaches does not appear to yield capital requirements that are commensurate with the true riskiness of the securitization exposure. As mentioned above, there is a greater propensity for markets to become de-stabilized when the link between risk and required capital is weak or non-existent. Some early observations made from the QIS results that demonstrate the lack of risk-sensitivity in the calibration of the approaches include: the inability for investors and intermediaries to utilize the MSFA based on the proposed requisites, the lack of comparability (as was intended) in the resulting capital requirements between the Simplified Supervisory Formula Approach (SSFA) and Revised RBA approaches, and the lack of consistent evidence demonstrating that capital requirements become more punitive as one moves down each level of the hierarchy.

We would recommend that calibration of risk weights be evaluated on a granular level and reflect the performance of the asset classes and related structures involved during the last economic downturn relative to other asset classes (e.g. subprime and Alternative A RMBS/Collateralized Debt Obligations (CDOs)), which exhibited weakness and appear to be driving the increased risk weights for all securitizations.

We also recommend that structure enhancements (e.g. credit enhancements) be fully reflected in the calibration of risk-weights. For securitization structures that have certain types of underlying assets (e.g. auto loans, auto leases), credit enhancements increase as the amortization period decreases. In fact, it is not uncommon for credit enhancements on securitizations that have certain types of underlying assets to exceed total exposure as the structure approaches maturity (i.e. credit enhancement > 100%). The revised framework should properly reflect these enhancements as they significantly reduce exposure risk.

Finally, there should be multiple rounds of QIS exercises so that the proposed floor and approaches are calibrated to a level that is more commensurate to the true risk of the securitization exposure. By analyzing multiple rounds of industry data under different calibration methodologies, the Basel Committee can best determine fair and risk-sensitive approaches. It is worth noting that multiple rounds of QIS were used in the development of the final Basel III Liquidity rules.

² Fitch Voice: [New Perspective of Losses in Global Structured Finance Transactions](#), October 31, 2012.

Early amortization provision revisions

We would like to note our concern regarding the revision of the early amortization provision. Although clarity is required on the exact proposal, we are concerned that any limitation in the recognition of risk transfer for structures that include an early amortization trigger would limit Canadian banks' ability to continue securitizing their revolving credit portfolios, as most of them have successfully done in the past. This would undoubtedly have a significant impact on credit availability, as funding these receivables would become more expensive. If the Basel Committee decides to de-recognize risk transfer for such structures, a proper transition period and grandfathering of current exposures would be required to ensure a smooth transition to the new regulatory rules.

Hierarchy A vs. Hierarchy B

Canadian banks have worked diligently with the oversight and guidance of the Office of the Superintendent of Financial Institutions (OSFI) on the establishment of internal support processes for both the Internal Assessment Approach (IAA) and the Supervisory Formula Approach (SFA). Through examination and review, the rigour of both the credit assessment and determination of the related capital requirement has been tested through a period of tremendous change. The Canadian banks prefer a hierarchy that builds upon and encourages further development of the resulting credit disciplines and processes.

Regardless of choice of hierarchy alternatives, it appears the resulting framework will require: (i) significant and costly modifications to the processes that Canadian banks have invested in and developed since the adoption of Basel 2.5; and (ii) an increase in the amount of capital needed to be held against all of their securitized exposures. As such, we believe efforts should be focused on finding the right calibration (e.g. maturity adjustment and floor), as opposed to any specific hierarchy.

Although we continue to study the Basel Committee's technical papers and the MSFA and Revised RBA, we note the following initial comments on the proposal:

- Where Canadian banks have made significant investments in the RBA and IAA, a level playing field concern exists with Hierarchy A should the desire to retain the Revised RBA/IAA processes disadvantage them relative to any revisions to the higher tier MSFA³. Importantly, we feel strongly that the IAA should be retained as an alternative for the Canadian banks. This framework requires significant interaction among banks and regulators and also requires that banks demonstrate their proficiency with such transactions through adherence to a robust protocol set forth in OSFI's Capital Adequacy Requirements (CAR) Guideline. We feel that disallowing the IAA because the US Congress prohibited its bank regulators from incorporating ratings into their capital regimes is inappropriate, arbitrary, and fails to consider the substantial and positive experience and track record of the IAA as well as the commensurate benefits that flow to Canadian borrowers.

³ As currently drafted, we do not anticipate the MSFA being applicable for banks that provide backstop facilities to ABCP conduits due to the requirement that the Probability of Default (PD) and Loss Given Default (LGD) be known for each of the assets that collateralize the securitization transactions that are funded by the ABCP conduits.

- Similarly, between jurisdictions, adoption of either the MSFA or Simplified SFA (SSFA) because of the non-availability of the Revised RBA/IAA may create an uneven playing field. An uneven playing field will reduce issuance in the Canadian securitization market.
- Reservations about Hierarchy B include: (i) the subjective determination of “high quality”; and (ii) the potential cliff effect that can occur when a securitization exposure is no longer considered “high quality”. To help mitigate the cliff effects, we recommend that the next step on the decision tree should fall to the Revised RBA approach (i.e. before the Concentration Ratio Approach).
- Some Canadian banks may use the Revised RBA (regardless of the hierarchy chosen) as the detailed data to calculate the IRB capital requirements is not available for the underlying pool of securitized assets (K_{IRB}) for customer pools, and the use of proxies is not defined. This includes asset classes where banks are not directly involved (e.g. auto leases).
- Other banks may prefer to apply the MSFA under Alternative A for all assets, which is intended to provide less conservative capital treatment in the hierarchy, as it encourages banks to independently perform comprehensive analysis and understanding of the risk of the underlying assets without reliance on agency ratings. With this in mind, the Basel Committee should recognize potential data limitations for some asset types that may result in making full compliance with IRB requirements a challenge. Therefore, it is recommended that the IRB rules should be relaxed to allow some flexibility for banks to assess risk parameters for calculating K_{IRB} for the underlying assets. Analyses show that using portfolio level estimates of Probability of Default (PD) and Loss Given Default (LGD) as drivers of the MSFA calculation result in reasonable and conservative estimates of capital when the data for each underlying asset is not available. We propose that sophisticated market participants be allowed to make use of portfolio level estimates of PD, LGD, and term to calculate the K_{IRB} , and therefore also make use of the MSFA to calculate the regulatory capital for securitization exposures. This approach would have many desirable characteristics, such as: (i) not relying on ratings; (ii) requiring fewer estimations and less modeling than the baseline MSFA; and (iii) being highly resistant to “gaming” and promoting transparency in the market by creating a demand for timely and accurate portfolio level loss data from the originators. We propose that strict guidelines be put in place around the way banks parameterize the portfolio level PD and LGD estimates in order to reduce the possibility of errors.
- As Canadian banks’ securitization exposures originated post financial crisis are significantly different from exposures originated prior to the financial crisis, our overall preference for hierarchy A or B is highly dependent on transition arrangements.
- Removal of reasonably conservative re-securitization risk weights in the Revised RBA table coupled with the inability of banks to utilize the IAA or Revised RBA for re-securitizations where, pursuant to higher levels in the hierarchies, the banks are fully capitalizing the underlying securitizations that serve as the collateral for the re-securitization, creates an unduly punitive regulatory capital outcome. This issue is relevant for banks that provide liquidity facilities and program-wide credit enhancement facilities to ABCP conduits. Banks that utilize the IAA assign risk weighting to the backstop liquidity commitments in a manner that: (i) assumes the bank owns the underlying securitization (i.e. there is no conversion factor to reduce the risk weights below direct ownership); and (ii) does not have the benefit of structural protections afforded to liquidity providers (e.g. the requirement to no fund defaulted receivables). In essence, the capital assigned in the IAA process is at least as conservative as the capital that is assigned to owning the asset directly on the bank’s balance sheet. The current proposal requires that banks capitalize the program-wide credit enhancement as a re-

securitization (note: the sum total of backstop liquidity facilities and program wide credit enhancement exceeds 100% of the ABCP conduit liabilities). As a result, banks cannot avail themselves of any of the capital methodologies that sit higher than the Backstop Concentration Ratio Approach (BCRA) in the hierarchy. The impact of this “blunt” re-securitization approach is a material increase in regulatory capital when compared to the regulatory capital that would be required by the IAA application to the liquidity facilities (which are treated as owning the related securitization directly on the banks’ balance sheets).

Transition Arrangements

Notwithstanding changes to be made following the consultation period, the proposal will certainly affect business practices and pricing. To avoid unintended market impacts and cliff effects for banks’ current exposures, we recommend a transition period that would allow market participants to adapt to the new rules. For instance, we recommend grandfathering existing exposures, both in terms of methodology and rating requirements. Further, to remove uncertainties around a market so fundamental to the funding of certain institutions (and to the economic recovery), we would recommend a confirmation from the Basel Committee as to its intentions regarding transition arrangements.

We thank you for taking our comments into consideration and look forward to future discussions on these issues.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Starks", is positioned below the word "Sincerely,".

Attachment: Detailed comments

cc:

- Joel Starks, Director, Securitization and Structured Products, OSFI Capital Division
- Ian Gibb, Capital Specialist, OSFI Capital Division
- Mary Thomas, Analyst, OSFI Capital Division

CBA comments on the Basel Committee’s consultative document: *Revisions to the Basel Securitisation Framework*

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Overall comments

Overall, while the main objective is to improve the risk sensitivity and prudential nature of the securitization framework, we also see this consultation as an evolutionary process to deepen understanding of risk management practices. As securitization is an important source of financial market funding and liquidity, we welcome the opportunity to share our experiences and offer some operational considerations. We note that the securitization market in Canada, while subjected to the same liquidity-related disruptions witnessed in credit markets globally, did not generate the same material credit losses for banks and investors that were observed in certain segments of the market in other jurisdictions. In fact, the principal financial impacts for banks and investors in Canada were temporary in nature, reflecting reduced market liquidity, and did not reflect the quality or performance of the Canadian assets or Canadian securitization structures. Further, no Canadian banks required “bailouts” or other financial assistance as a result of securitization problems. We believe that calibrations of the revised framework should consider this differentiation of asset quality and market structure, and the Basel Committee should afford local jurisdictions the discretion to adjust the floor for securitization of very-high-quality assets with sound structures

Performance of rated securitisations (page 4)

The Basel Committee’s policy response applies to all securitization exposures, regardless of experience, and is not focused on where shortcomings were exposed. It therefore introduces capital charges for high-quality exposures to cover model risk and uncertainty that became apparent only in certain jurisdictions and asset classes. We believe that the approach should be more risk-sensitive to reflect the actual underlying risk of the exposures.

Performance of unrated securitisations (page 4)

- In our view, regulation and supervisory systems should provide the opportunity and encouragement for banks to build and improve internal risk assessment processes and disciplines, not substitute generic models that limit opportunity for risk managers to better measure the risk.
- Application of generic models like the Supervisory Formula Approach (SFA), in practice, are works-in-process that should continue to be modified and re-calibrated to capture “all material aspects of the exposure” to ensure the capital result is aligned with assessments of economic risk. We believe that Simplified Supervisory Formula Approach (SSFA) and Modified Supervisory Formula Approach (MSFA), however, will deviate from sound risk analysis because of the simple assumptions underlying the calculations.
- Given the proposed increased importance of SFA based alternatives, or effectively Internal-Ratings Based (IRB) for the underlying assets, compliance with IRB requirements that underpin the SFA and proposed “cap” (based on the risk weight (RW) if assets were directly owned by the bank) will be crucial, and further reinforces the need to address well known inconsistent implementation standards across

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jurisdictions. Consistency from regulators will be crucial to ensure level playing field. As is, implementation of IRB requirements for non-securitized assets is subject to variation in practices across different jurisdictions.

Shortcomings of the securitisation framework (pages 5 - 7)

We believe that asset pools backing securitizations warrant lower capital charges based on the level of enhancement providing credit support. Generally, the experience of the Canadian securitization market during the recent crisis supports this view. Canadian securitization market is largely backed by granular, homogenous assets. We believe that an increase in RW in respect of securitizations that are highly-rated and backed by high-quality assets is punitive. Below is feedback to the stated shortcomings of the securitization framework outlined in the consultation paper.

Mechanistic reliance on external ratings:

- We agree that over-reliance on external ratings is inappropriate and can lead to under-resourcing of credit functions within banks. This lesson was learned by non-bank institutional investors who have responded to the impacts of the credit crisis by bolstering the strength and role of internal credit assessment groups.
- External ratings should not be disregarded entirely though, as they remain a source of experienced and well-funded credit research, as they have data that is far broader than any single (or group of) banks might possess. Rather, they should be considered in the internal credit and capital assessments.
- External ratings do provide the benefit of giving a consistent rating methodology across banks and jurisdictions. Consistent internal credit assessment should be assured across institutions and jurisdictions to achieve a level playing field. In addition, general investors clearly want consistent and reliable ratings, as they do not have the capability to do their own.
- Instead of taking the external rating at “face-value” or prohibit their use, we believe the right approach would be to ensure that banks understand the differences between external-ratings methodologies and internal-rating methodologies and explicitly consider any differences in their transaction reviews.

Too low RWs for highly-rated securitization exposures:

- Positing a broad statement that “risk weights for highly-rated securitization exposures are too low” fails to identify where the RWs for senior high-quality exposures proved to be appropriate, and looks past any effort to understand why performance differences exist.
- Policy responses that reset specific capital factors have a direct impact on the economics of bank involvement in this form of credit transmission. As a result, proposals need to be designed and assessed in terms of their impact on:
 - the safety and soundness of the banking system (domestically and globally),
 - the need for continuous markets, and
 - the economic imperative to preserve and steer innovation for low cost, properly adjudicated credit for consumers and commercial enterprises.
- Most banks originate securitization exposures as a means of providing credit to its consumer and commercial clients, not as a means of diversifying its own exposures. Portfolio diversification objectives factor into the impact of the securitization exposures, but do not use securitization to achieve or rebalance targets.

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- Securitization credit support levels are designed to cover all losses over the life of the funded collateral pool at a certain level of confidence. Many factors are assessed in coming to this determination (historical performance, diversification, asset and obligor quality, servicer strength, etc.). Credit support in almost all cases is provided on a “paid-in” basis by the originating client, and this serves as a critical source of equity support for the transaction. Importantly, that retained support from our clients is not recognized as capital in Basel capital definitions. Consequently, the capital the bank is required to hold to fund the senior positions in auto loan, trade account receivables, and other pools (already supported by the client’s equity stake) are best set based upon a full awareness of the sources of structural support and the nature and quantum of the risk it is exposed to. Credit assessments do that. Capital RWs that are set at levels well in excess of the risk (floored at 20-58% and capped at IRB RW for non-credit supported whole loans held by the bank) effectively require that the same risk be covered by two levels of capital – the client’s and the bank’s. As markets adjust, the most efficient way for banks to provide funding to commercial consumer finance clients is to simply purchase the assets on a “whole loan” basis to avoid the inefficiency of the capital double count. This introduces risk into the banks which they are not exposed to though funding senior exposures to the assets.
- We believe that shortcomings of the current SFA and proposed MSFA are best identified in practice and modified in consultation with domestic regulators.

Cliff effects in capital requirements:

- Ratings-related “cliff effects” result from the absence of non-RW leverage constraints (other than in Canada), where banks have been incented by risk-weighted capital system to accumulate large volumes of low RW exposures.
- The focus should be on placing effective limits on what banks can hold on their balance sheet by layering a leverage constraint on top of the RW approach (which is needed to maintain focus within that on the relative risk-return relationships of alternative investment opportunities), not on turning the RW system into a non-RW system by introducing factors that are materially less risk-insensitive.
- In Canada, the existence of a leverage measure acted as a constraint on accumulating large exposures to low RW investments such as securitization. We recommend that the Basel Committee investigate the interplay between the leverage ratio and the incentives for these investment decisions.
- To what extent is the Basel Committee investigating how much the introduction of a non-RW leverage test on its own will limit the extent to which banks are incented to accumulate large positions in low RW investments (AAA-rated Residential Mortgage Backed Securities (RMBS), AAA-rated Collateralized Debt Obligations (CDOs), sovereigns, etc.) going forward?
- How much will the limitation of a bank’s capacity to assume these exposures (i.e. demand-side) contribute to banks’ prioritization of client funding support, rather than discretionary investment, when focussing strategy in their securitization businesses (supply-side)?
- We believe that the lessons learned from the Canadian experience should not be minimized:
 - In Canada, the Assets-to-Capital Multiple (ACM) played an important stabilizing role, coupled with the RW capital framework, in establishing clear notional balance sheet size constraints.
 - While, on occasion, the fairness of having a dual capital constraint (while other jurisdictions did not) was raised by Canadian banks with their regulator for international competitiveness reasons, the safety and soundness rationale of the dual approach was always well understood and accepted.
 - The ACM has served to reinforce the need within Canadian bank treasury groups for balance sheet management disciplines, like opportunity cost assessments and internal exposure limits, that led to: (i) a clear prioritization of direct customer support business, and (ii) real disincentives for accumulating larger low yield investment positions outside of required liquidity reserve positions.
 - This limited the impact that severe price deterioration in global credit markets had on Canadian bank capital positions.

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II. CONSIDERATIONS AROUND THE HIERARCHY OF APPROACHES (Pages 7 – 12)

Background: the hierarchy in the current securitisation framework (page 7)

Far from restrictions on the Internal Assessment Approach (IAA), we see a broader application of the methodology where banks work closely with regulators on limited types of securitization transactions. (For your consideration, please see suggestions in the response to Question 4 below). Does the Basel Committee agree with this approach?

Proposed revisions to the securitisation framework hierarchies (pages 8 – 12)

Question 1: What additional costs and benefits of the two hierarchies should the Committee consider? Which hierarchy presents the greater benefits relative to its drawbacks? Which hierarchy would best address the shortcomings identified with the current framework, whilst meeting the Committee's objectives?

We are unable to provide a fulsome response to this question (indeed all 24 questions posed in the consultative document) in the absence of further information, which we expect will be available from the Quantitative Impact Study (QIS). In this context, we provide our preliminary comments below.

Canadian banks have worked diligently with OSFI's oversight and guidance on the establishment of internal support processes for both the IAA and the Supervisory Formula Approach (SFA). Through examination and review, the rigour of both the credit assessment and determination of the related capital requirement has been tested through a period of tremendous change. The Canadian banks prefer a hierarchy that builds upon and encourages further development of the resulting credit disciplines and processes.

Regardless of choice of hierarchy alternatives, it appears the resulting framework will require: (i) significant and costly modifications to the processes that Canadian banks have invested in and developed since the adoption of Basel 2.5; and (ii) an increase in the amount of capital needed to be held against all of their securitized exposures. As such, we believe efforts should be focused on finding the right calibration (e.g. maturity adjustment and floor), as opposed to any specific hierarchy.

We note the following initial comments to the proposal:

- Both alternatives have shortfalls that over-emphasize loan-level data that is not material to homogenous diversified pools.
- Given the Basel Committee's primary objectives are to (i) reduce reliance on CRA, (ii) improve risk sensitivity and RW calibration and (iii) reduce cliff effects, it would appear that overall Alternative A relative to B has more benefits than drawbacks.
- There are drawbacks of Hierarchy A if the bank has more senior high-quality exposures. For non-senior high-quality exposures, Hierarchy B is less risk sensitive. However, the approach for non-senior high-quality, Concentration Ratio based on K_{IRB} (CR_{KIRB}) approach:
 - Does not factor in thickness of the tranche,
 - De-linking from external ratings loses its advantage if the alternative is a more blunt approach.

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- Alternative A (assuming calibration/cliff effects have been corrected and MSFA generally will result in relatively lower RWs among the proposed available approaches), would overall be more beneficial than Alternative B, as it provides incentive for the bank to complete internal risk assessment of the underlying assets. However, if the jurisdiction selects Ratings-Based Approach (RBA) as the next hierarchy, this would revert back to primary reliance on RBA.
- Alternative A seems to limit a bank's discretion in selecting an appropriate capital methodology more than Alternative B. Basically, Alternative A dictates MSFA when conditions are met, and if not, the jurisdictional regulator dictates using either (i) SSFA or (ii) Revised RBA/IAA. On the other hand, Alternative B has the same options (MSFA, SSFA, Revised RBA, or IAA), but seems to grant banks discretion over which methodology to use.
- For Alternative B, given the option and if the RW differential between RBA and MSFA is not material, banks will likely continue to rely on RBA for senior high-quality tranches.
 - While banks, for strategic and risk appetite reasons, will focus on originating and/or funding senior high-quality securitization exposures, many banks will continue to hold legacy exposures that may not fit in the senior high-quality category. Under Alternative B, these exposures would be adversely affected unless capital levels are grandfathered upon adoption of the new hierarchy. Guidance from the Basel Committee on how legacy exposures will be treated so as not to bias the view on alternative hierarchies would be appreciated.
- Under Alternative B, are there cliff effects associated with the determination between (i) senior high-quality assets and (ii) all other tranches? And in practice, how will this determination be made?
- It seems there will be certain asset classes that get forced into capital adverse methodologies. For example, generating delinquency data for CLO exposures could be difficult.
- The capital methodologies should not systematically bias assets financed in a securitization structure. The same pool of assets should attract the same capital regardless of being funded as separate bank loans or using securitization technology.

Impact to Program-Wide Credit Enhancements

The following relates mostly to the impact on program-wide credit enhancement and the pro-forma cumulative capital that would flow from the proposals. As an example, banks provide liquidity facilities and credit enhancement facilities to conduits. In this capacity, the bank's role is one of an intermediary (not an originator in the economic sense). This means that the bank probably will not have the level of information required to utilize the SFA or MSFA. So, going through the hierarchy, many banks will use the IAA when capitalizing the liquidity and credit enhancement facilities. When Basel II.5 was released, the regulators inserted additional RW columns for senior and non-senior re-securitization transactions. For banks that treat the program wide-credit enhancement facilities as re-securitizations, the associated risk weighted asset (RWA) increased relative to Basel II.

Now, in the December 2012 proposal, there is the following language:

"Similar to the current securitisation framework, an IRB bank would be permitted, under certain conditions, to use the IAA to calculate risk-based capital requirements for unrated securitisation exposures to an ABCP programme. The IAA would be permitted only in jurisdictions that chose to use the revised RBA. In addition, an IRB bank could only use the IAA if the bank were not able to use the MSFA. As under the current framework, the IAA would be available for certain securitisation exposures to ABCP programmes (e.g. liquidity facilities and credit enhancements) and provided that the ABCP, the bank, and the External Credit Assessment Institution (ECAI) met certain criteria (see Basel Accord paragraphs 619 to 622)."

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We do not believe that anything has changed and so expect that banks will continue to capitalize liquidity and credit enhancement facilities under the IAA. However, there are some conflicting provisions of the December 2012 proposal. First, Hierarchy A says that banks need to follow the appropriate Backstop Concentration Ratio Approach (BCRA) methodology for re-securitization despite the above language. We believe that the above language should apply (we note that the BCRA is hugely punitive). Second the RW tables on page 16 no longer include re-securitization RWs for senior or non-senior re-securitization, meaning the applicable risk (if we follow the above language) would be the same for re-securitization and securitizations. Third, on page 9, the proposal states that the IAA is only available in jurisdictions that “chose to use the Revised RBA”.

If a conduit holds AAA positions (2.5 year average life) and has 10% program-wide credit enhancement, the estimate regulatory capital requirement today would be about 90 basis points (bps). If we use the table on page 16 for 90% of the liquidity facilities and the BCRA (in Hierarchy A) for the 10% program-wide credit enhancement, we get an estimated regulatory capital cap requirement of close to 5% which is > 500% increase in capital.

We recommend that program-wide credit enhancements not be treated automatically as a re-securitization exposure, since if we are underwriting each underlying securitization, we should not default to the BCRA.

(i) Alternative A (pages 8 – 10)

Question 2: As regards Alternative A, could both the revised RBA and the SSFA be accommodated without raising concerns about regulatory arbitrage or level playing field?

We believe that the onus should be on the regulator to ensure there is level playing field through mechanisms such as regular benchmarking surveys and sharing the results with the banks in their jurisdiction. Another consideration is to define the acceptable ratings range applicable to senior high-quality and MSFA/SSFA RWs would be capped at the RBA RWs of the worse rating.

Alternative A:

- Alternative A suggests using the MSFA approach as the first approach, and then based on jurisdiction's choice to use the RBA /IAA or the SSFA. However, the SSFA still requires detailed information about the underlying assets in order to calculate the average RW. In all probability, ABS investors, derivative counterparties, intermediaries may not have access to this detailed data as required under the new proposal. Would this then force the above-mentioned participants to RW their unrated exposures at 1250% because these exposures do not have sufficient information to calculate the Supervisory Approach (SA) or IRB capital requirements? Furthermore, if the detailed data necessary for the SSFA or MSFA calculations is available for a portion or a majority of the underlying pool of assets, but not for all assets, does this approach force a 1250% RW for the entire pool? Finally, the BCRA uses as input the capital charges applicable to the underlying pool using RW under the SA for credit risk (Ksa), information that is not available, thus results in a 1250% RW again.
- We request clarification on what information is required to estimate IRB and if exceptions with estimates will be acceptable. With portfolios

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that are purchased from third-party sellers, we may not get all of the information exactly as required for IRB calculation. To the extent we do not and there is no flexibility, we are back to the existing rules where two ratings are required, and we will have a set of rules that still has a mechanistic reliance on external ratings.

- The introduction of maturity is probably more aligned with the Advanced IRB (AIRB) credit framework for wholesale assets classes (but not for retail assets), but the interpretation of the actual maturity may be subjective and vary from one bank to another.
- Alternative A facilitates comparability between banks calculation within the same jurisdiction, as choice of approach is determined by the regulator but still lead to potential uneven playing field between jurisdictions.
- We request clarification on whether the linear interpolation is allowed for the purposed of determining the maturity under the Revised RBA approach.

(ii) Alternative B (pages 10 – 12)**Question 3: As regards Alternative B, which methods could a bank use to conclude that a securitization exposure is of high-quality?**

- Some simple qualitative criteria should be in place; otherwise, Hierarchy B is subjective and could create level playing field challenge.
- Other criteria or combination of criteria can cover asset type and characteristics (e.g. well diversified pool of prime residential mortgages or credit cards, minimum quantitative threshold tests, credit enhancement level, default/loss rates). These criteria will need to be sufficiently robust to capture performance stability as expectation is that the exposure will continue to qualify as high quality and material deterioration is remote.
- Consider harmonizing with the US Federal Deposit Insurance Corporation's High Risk Securitization definition.

Q3 (continued) Would the use of these methods likely result in a capital charge consistently related to credit risk across banks and countries?

- Not likely. Hierarchy B seems to be more punitive than the proposed US SSFA (i.e. Notice of Proposed Rulemaking). The relationship depends on how parameters were calibrated. Further technical information is required.
- Regulators in different jurisdictions also need to agree to work collaboratively to achieve reasonable alignment in implementation of MSFA/SSFA.

Q3 (continued) Would Alternative B produce material cliff effects as exposures deteriorate below high-quality?

- Yes, it can.

Question 4: Are there alternative hierarchies or revisions to the two proposed (or a combination of both) that the Committee should consider?

We suggest two alternative hierarchies: (1) An improvement on Alternative B to reduce the cliff effect by making Revised RBA and MSFA/SSFA available to non- high-quality exposures, and (2) An intermediary and investor assessment approach from the conduit perspective to carve out

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the IAA approach.

(1) Modified Hierarchy B

For Hierarchy B, in order to help mitigate the cliff effects that can result when a securitization exposure no longer qualifies as “high quality”, we recommend that the next step on the decision tree should fall to the Revised RBA (i.e. before the BCRA). The RBA has lower RWs for mezzanine and junior tranches than other approaches, resulting in more gradual increased capital charges from credit downgrades. This will make Revised RBA available to non-high-quality securitization exposures, which will alleviate the issues associated with artificial cut-off for “high quality” vs. “non-high quality”.

(2) Intermediary/Investor Internal Assessment Approach (IAA)

An alternative framework would explicitly take into consideration the reality that banks can play different roles when it comes to securitization. Banks can certainly originate and securitize their own assets. In this role, banks should be able to avail themselves of the SFA or MSFA because they have all the relevant detailed information on the underlying pool. The result should then be a lesser amount of regulatory capital, all things being equal.

Banks do, however, act as intermediaries (e.g. liquidity provider to ABCP conduits) or as an investor (e.g. purchase ABS or perhaps extend a loan to an asset-backed transaction). In these instances, the bank generally does not originate or service the underlying collateral and as result, it is more challenging to obtain the detailed information necessary to utilize the SFA or MSFA.

As an alternative to the proposed A and B hierarchies, we suggest an “Intermediary/Investor IAA”. The banks would use a process similar to the IAA to set capital if they cannot avail themselves of the SFA or MSFA. We would envision the following minimum requirements:

- Regulatory approval;
- Approved asset classes only (e.g. prime retail collateral, asset classes where the bank already has Advanced Approaches, etc.);
- Minimum risk reviews of the internal ratings and associated processes;
- Quarterly reporting to the regulators related to the use of the “Intermediary/ Investor IAA” approach including notional, asset class, rating, capital and relevant performance statistics;
- Investment grade only;
- No re-securitizations.

The result would be more regulatory capital for the banks when compared to SFA or MSFA, but incentives to:

- focus on investment grade positions;
- demonstrate expertise with the process;
- ongoing reporting of the relevant transaction and rating information;
- limit application to asset classes that are not like sub-prime mortgages or the alphabet soup of pre-crisis (CDO², CDO of MBS, etc.);
- increase regulatory touch points.

This would avoid the punitive and risk-insensitive results arising out of BCRA or CR_{IRB} due to data granularity requirements when robust (but not exact) data is available historically, at transaction effective dates, and on an ongoing basis.

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Alternative B – Other Considerations:

- The same scenario arises for Alternative B for all other non-highly-rated tranches where the CR_{KIRB} requires detailed information of the underlying assets.
- We agree and encourage that the RBA approach under both the SA and IRB should be the same.
- We request clarification on the circumstances that supervisors will restrict MSFA.
- Alternative B seems to provide a less onerous (cost and charge) proposal for the senior tranches, but it leaves the non-senior high quality assets tranches in the same increased cost environment as the more junior tranches since the approach does not differentiate between high quality assets and riskier assets.
- The determination of senior high-quality tranches may be subjective and does not reduce the dependence on external credit ratings.
- With the increased reliance on the bank assessment of risk for the underlying exposures, regulator could consider the IAA as one approach for such task, rather than limiting the methodology for credit enhancement and liquidity facilities.
- Under both proposed hierarchies (MSFA and CR_{KIRB}), obtaining granular pool level data for some legacy purchased deals may be challenging. Could Revised RBA be used as a grandfathering option?

III. PROPOSED APPROACHES IN THE SECURITISATION FRAMEWORK (Pages 12 – 30)

- While we support the goal of better alignment of capital levels under different approaches - Revised RBA and MSFA – to minimize arbitrage opportunities, it is not clear from the proposal how this will be achieved, as the MSFA is relying on individual banks' assessed Probability of Default (PD) and Loss Given Default (LGD) assigned under the IRB approaches. To ensure there is reasonable alignment for similar assets types, we suggest benchmark levels or similar floor/caps for PDs and LGDs for certain generic and homogeneous asset types such as mortgages and credit cards.
- Revised RBA and MSFA approaches are intended to reflect lessons learned during the crisis but do not differentiate the type of assets and/or structural aspects (e.g. credit enhancement), and/or consider other market factors that contributed to the higher unexpected losses for some securitizations (i.e. not all, during the crisis). This would unnecessarily penalize securitizations that are structurally sound and/or with high-quality underlying assets.
- Proposed MSFA requirements may also be more stringent than existing SFA, making it even more challenging to comply with. To facilitate use of the MSFA/SSFA and minimize implementation burden, IRB requirement may need to be relaxed to allow sufficient flexibility on data required to calibrate PDs and LGDs for underlying assets.
- New SSFA and Concentration Ratio Based Approaches similarly can result in substantially uneconomical capital requirements. The BCRA appears to have excessively conservative RWs. If re-securitizations are limited to using the BCRA, definition of re-securitization should be revised as capital treatment may be punitive for securitizations with immaterial structured assets in the overall underlying assets.

Revised Ratings Based Approach (RBA) (pages 12 – 19)

Question 5: The Committee recognises that in some instances and in some jurisdictions, the requirement for two external ratings could be difficult to implement or could impose additional costs on banks. The Committee requests feedback on the relative merits of reducing idiosyncratic, rating agencies' modelling risk with the costs of using two ratings and/or whether exceptions to this

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treatment should be permitted.

The current rules in Canada generally require two ratings; how will the Basel Committee ensure that there is harmonization across jurisdictions on the external ratings requirements for a level playing field?

We recommend that grandfathering of applicability of single external ratings for the RBA should be provided for existing structures, which is consistent with OSFI's October 2008 *Securitization – Expected Practices* notice on the matter.

We caution that requiring the use of the “lowest” of two ratings, or the “middle” of three ratings, might not produce desired results:

- Ratings could be on “review for possible upgrade or downgrade”.
- Ratings could be stale (i.e. not properly monitored).
- Ratings could be subject to a methodology that is either stale or in the state of being revised.
- Using the lower of two ratings – or the middle of three – does not get around the cliff issue and is still a mechanistic approach. The consultative document still proposes the RBA be used when a securitization is externally rated. Ratings are also used under Alternative B to determine “senior high” quality exposures.
- Securitization investors should have the discretion to use the rating that makes the most sense (when the ratings are not the same) rather than be required to use the lowest of the two (or middle of the three), provided that there is a good rationale and analytical justification for the use of a more favourable rating given application to the facts and circumstances; more so if the investor can understand differences between the agencies' rating methodologies and their own internal methodologies, in order to arrive to a more informed decision.
- Having to have a minimum of two ratings will likely result in having few transactions that qualify. This will likely mean more transactions are done without ratings. This is not necessary beneficial, as external ratings do serve as a benchmark and enhance liquidity and tradability.

Question 6: Is the RBA appropriately calibrated and formulated? Should other risk drivers be incorporated?

Even though we look favourably at the inclusion of additional drivers, we need more time to further evaluate the impact of this proposed methodology.

In terms of the IAA application, in order to circumvent level-playing field issues, we recommend that the IAA's scope be expanded so that it is able to be applied to all unrated securitization exposures (i.e. not just to exposures that the bank extends to an ABCP conduit). Hence, under Alternative A, the IAA would be permitted to be applied to all unrated securitization exposures in jurisdictions that choose to use the Revised RBA and where the MSFA cannot be used. Similarly, under Alternative B, the IAA would be permitted to be applied to all unrated securitization exposures that are senior high-quality tranches.

Granularity of the securitized assets relative to the thickness of the tranches is still an important risk driver, especially when the LGD of the assets is high or unpredictable. In addition:

- The floor proposed under the Revised RBA does not allow for the differentiation of good underlying assets with low losses.
- We request confirmation that the illustrative table 2, “RBA RWs”, is for illustration purposes only, and that the two maturities represented in the table are only examples of RWs by rating. Would the Basel Committee confirm that the actual RW is to be calculated with the formulas

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provided?

- The minimum RW of 20% for AAA is at the same level as A-rated security in the existing RBA/IAA table and, in general, seem to benchmark closely to RWs of an unsecured corporate A/A- credit with similar maturities.
- The assumption that the pool of underlying assets is “B” rated for calibration of RW for all tranches rated BB or better seems overly conservative for AAA/AA tranches given that the calibration of tranches rated B or worse assumes underlying pool is 3 notches worse than the tranche rating.
- We believe the calibration result of a 58% RW for a 5-year AAA rated securitization is also overly punitive, in particular when we take in consideration of high-quality underlying assets such as autos, equipment, and credit card Asset Backed Securities (ABSs).

Modified Supervisory Formula Approach (MSFA) (pages 19 – 22)***Question 7: Is it appropriate to require that in order for the MSFA to be used the IRB approach should be applied for all underlying assets?***

A materiality threshold (e.g. min 80% of underlying assets to apply IRB) could be established. Would the Basel Committee please clarify what is the definition of “purchased receivables” for which the top-down approach to estimate PD/LGD is allowed?

Question 8: Is the MSFA appropriately calibrated and formulated?

- We will be in a better position to answer any questions about calibration once the results of the QIS are available.
- MSFA capital charges depend on the credit enhancement levels and thickness of the tranches, tranche maturity and asset value correlations. This must be viewed not in isolation of other tranches or as an absolute by itself. The thickness of tranches must be considered in relative terms (compared with the credit enhancement, and the thickness of subordinated tranches).
- MSFA requires “sufficient information” to estimate IRB capital requirements for the underlying assets for the securitized pool. We believe that the term “sufficient information” needs to be defined and standardized to eliminate the perceived need for “uncertainty buffers”.

Q8 (continued) Does it incorporate the appropriate risk drivers?

Benefit of Excess Spread should be recognized to a certain extent. The treatment for guarantee and cash collateral should be reconsidered if these CRM provide first loss protection to the tranche. Proportional Cover approach works well when CRM is protecting tranche loss on a proportional basis, but fails to recognize the waterfall structure unique to securitizations when CRM is protecting tranche loss on a first-loss basis.

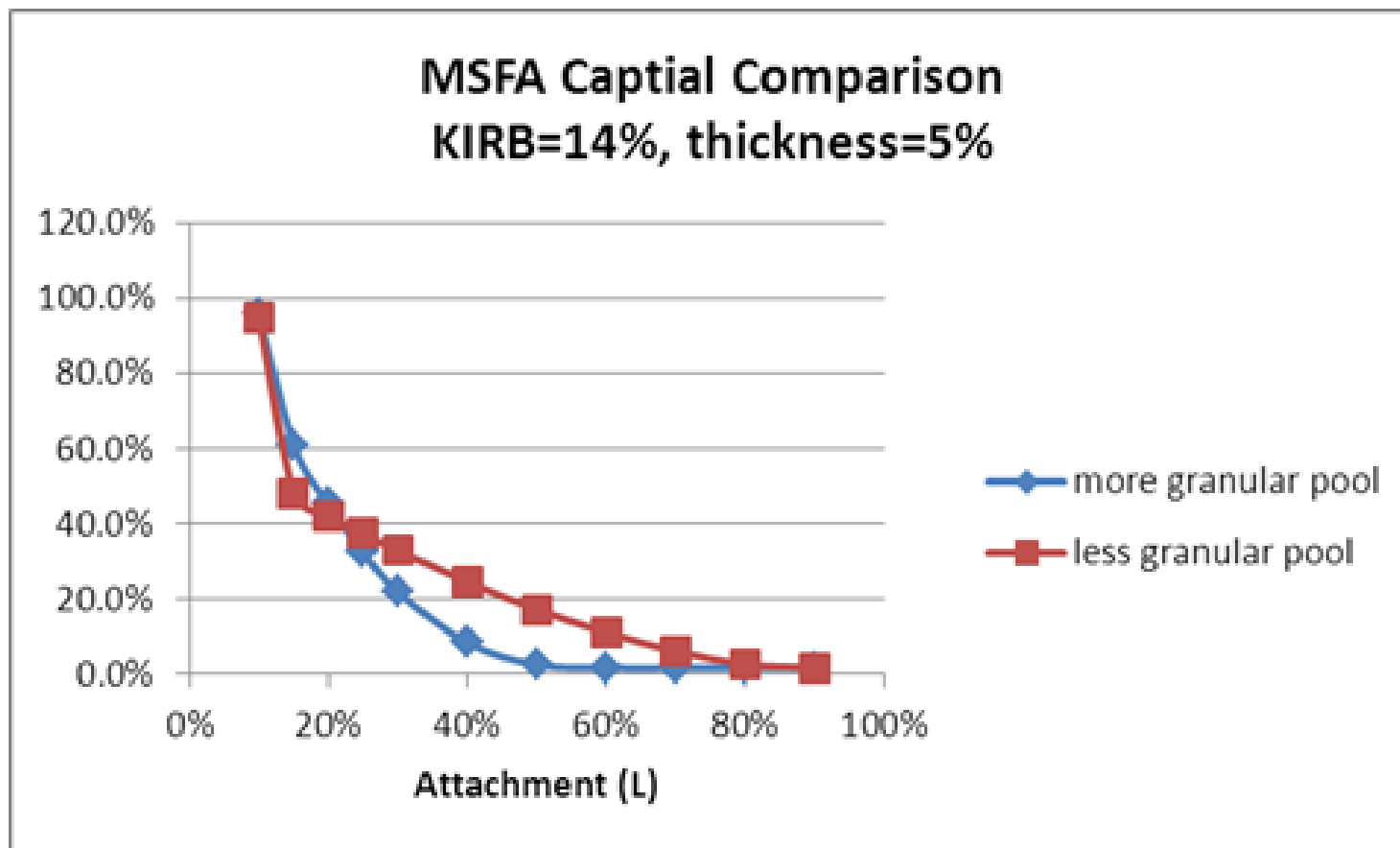
Q8 (continued) Is the calibration of tau and omega appropriate? If not, what evidence can respondents provide to support an alternative calibration?

When looking at more granular underlying asset pools vs. less granular, the MSFA can generate higher tranche capital when underlying asset

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pools are granular, all else being equal. This is observed when K_{IRB} is closed to attachment for thin tranches.

As shown in the table and the graph below, when the tranche attachment is close to K_{IRB} (i.e. attachment of 10%, 15% and 20%, with K_{IRB} of 14%), the MSFA capital with more granular underlying pools can be quite a bit higher than that with less granular pools.



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L	more granular pool	less granular pool
10%	96.1%	94.9%
15%	60.8%	48.2%
20%	45.3%	41.9%
25%	32.3%	37.3%
30%	21.8%	32.8%
40%	8.4%	24.5%
50%	2.4%	17.2%
60%	1.6%	11.0%
70%	1.6%	6.1%
80%	1.6%	2.6%
90%	1.6%	1.6%

Foundations of the Proposed Modified Supervisory Formula Approach

Page 6

In footnote 5, we disagree with the “apples-oranges issues”. The capital charge required is estimated over 1-year time horizon. The amount of capital required for the securitization equals the loss incurred to the tranche in a 99.9% percentile tail event over the next year. This tail loss is determined by the loss incurred to the underlying securitized assets in a 99.9% percentile tail event over the next year. Given that the capital estimated for the underlying securitized assets is a tail (extreme) loss over the next year, $[A-K_{IRB}]$ does not overstate the degree to which the tranche is protected against unexpected pool losses over the next year. There is no need to insure that $[A-K_{IRB}]$ is sufficient to protect unexpected pool losses over the life of the transaction for the capital purpose.

Regarding the capital concept over a 1-year time horizon for lending exposures:

- Assume there is a loan portfolio of \$1,000mm, PD=1%, LGD=50%, maturity=5 years.
- K_{IRB} (EL+ Capital) over next year is 11.5%.
- Assume that at the end of year 1, the tail event occurred (i.e. 23% of the portfolio defaulted; note that this is an extreme event given the PD of the portfolio is only 1%). With LGD of 50%, the loss incurred to the portfolio is 11.5%. The K_{IRB} set aside is sufficient to guard against this tail loss.
- In year 2, there is 77% of the portfolio, or \$770mm, remaining. The PD for the remaining portfolio may be estimated to be 10%. With LGD

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of 50% and remaining maturity of 4 years, K_{IRB} of 24% is set aside for year 2.

- Capital is estimated over 1-year time horizon, and it is estimated every year. There will be enough capital to guard against the tail losses over the life of the loan transaction.

Regarding the capital concept of an over 1-year time horizon for securitization exposures:

- Assume the pool above is securitized and there are two securitization tranches: Note B with attachment of 10% and detachment of 50%; Note A with attachment 50% and detachment of 100%.
- SFA capital for Note B and Note A are 5.8% and 56 bps.
- In year 1, the tail event occurred and the underlying losses amount to 11.5%.
 - For Note B, with 10% attachment, the loss incurred to the tranche is 1.5%. The SFA capital of 5.8% set aside is sufficient to guard against the loss occurred to Note B.
 - For Note A, the tail loss that occurred to the underlying securitized assets does not cause any losses.
- In year 2, we assume Note B is unwound given the loss incurred in year 1. Note A is still outstanding and servicer is put in other forms of credit enhancement for Note A. The SFA capital will be calculated for Note A accordingly. There will be still sufficient amount of capital for year 2. And so on.

In summary, the EL and capital estimated for the underlying securitized assets should be over 1-year time horizon. Capital is estimated every year with updated parameters if necessary. This will provide sufficient reserve to guard against tail loss over the life of the transaction. For capital purpose, it is not sensible to include expected losses beyond the capital horizon.

It can be argued that, based on 2008-2009 crisis, securitization transactions caused heightened default correlation (i.e. when one defaulted, a number of related transactions were affected at the same time, which is not observed in lending transactions themselves). Then, the SFA can be modified by adjusting the correlation parameter AVC in the IRB formula under the securitization framework only.

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For equation (7), we request clarification on whether capital is estimated over the maturity of the tranche as opposed to over a 1-year capital horizon. Is expected value taken on tranche principal at maturity and loss estimated over tranche maturity, as opposed to over a 1-year capital horizon?

When setting $M=1$ in the MSFA formula, expected losses beyond the capital horizon should be eliminated. The following two tables show a capital comparison of MSFA as proposed by consultative paper (i.e. MSFA when M is set at 1), and SFA. Table 1 provides the comparison where thickness of the tranches is thin: 5%; Table 2, where thickness of the tranches is higher: 50%. In both cases, tranche maturity is 5 years.

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Table 1. Tranche Capital Comparison – (Tranche Thickness 5%)

L	T	MSFA	MSFA (M=1)	SFA
10%	5%	97.28%	94.47%	92.01%
20%	5%	45.04%	14.66%	1.57%
30%	5%	22.49%	4.47%	0.56%
40%	5%	9.19%	1.60%	0.56%
50%	5%	2.94%	1.60%	0.56%

Table 2. Tranche Capital Comparison – (Tranche Thickness 50%)

L	T	MSFA	MSFA (M=1)	SFA
10%	50%	29.37%	15.75%	11.10%
20%	50%	13.48%	3.15%	0.56%
30%	50%	5.73%	1.60%	0.56%
40%	50%	2.01%	1.60%	0.56%
50%	50%	1.60%	1.60%	0.56%

Feedback on Working Paper No. 22, *Foundations of the Proposed Modified Supervisory Formula Approach*

In reviewing the MSFA technical document released February 2, 2013, one bank found that paragraph 77 opens the door to the possibility of using portfolio-level assumptions in conjunction with the MSFA (in lieu of loan-level calculations). The bank prepared an analysis (below), which supports the idea that for subsets of a portfolio with similar LGD and maturity, the use of a portfolio-level K_{IRB} calculation is conservative and reasonable.

Analysis

One of the stumbling blocks conduits and other regulated securitization market participants have faced is the requirement that in order to use the advanced regulatory capital methodologies (i.e. SFA and now MSFA), the K_{IRB} value must be calculated for each and every underlying asset in the portfolio. As many portfolios contain tens of thousands of positions, and the calculations must be updated periodically, this quickly becomes an impossibility for anyone but the originator.

A simpler approach, and one that can be employed using currently available information, would be to calculate the MSFA at the portfolio level, using portfolio average data such as the average probability of default, average LGD and a correlation value consistent with the average PD. We can show that in virtually every case the simpler portfolio-level approach is considerably more conservative (i.e. results in a higher capital

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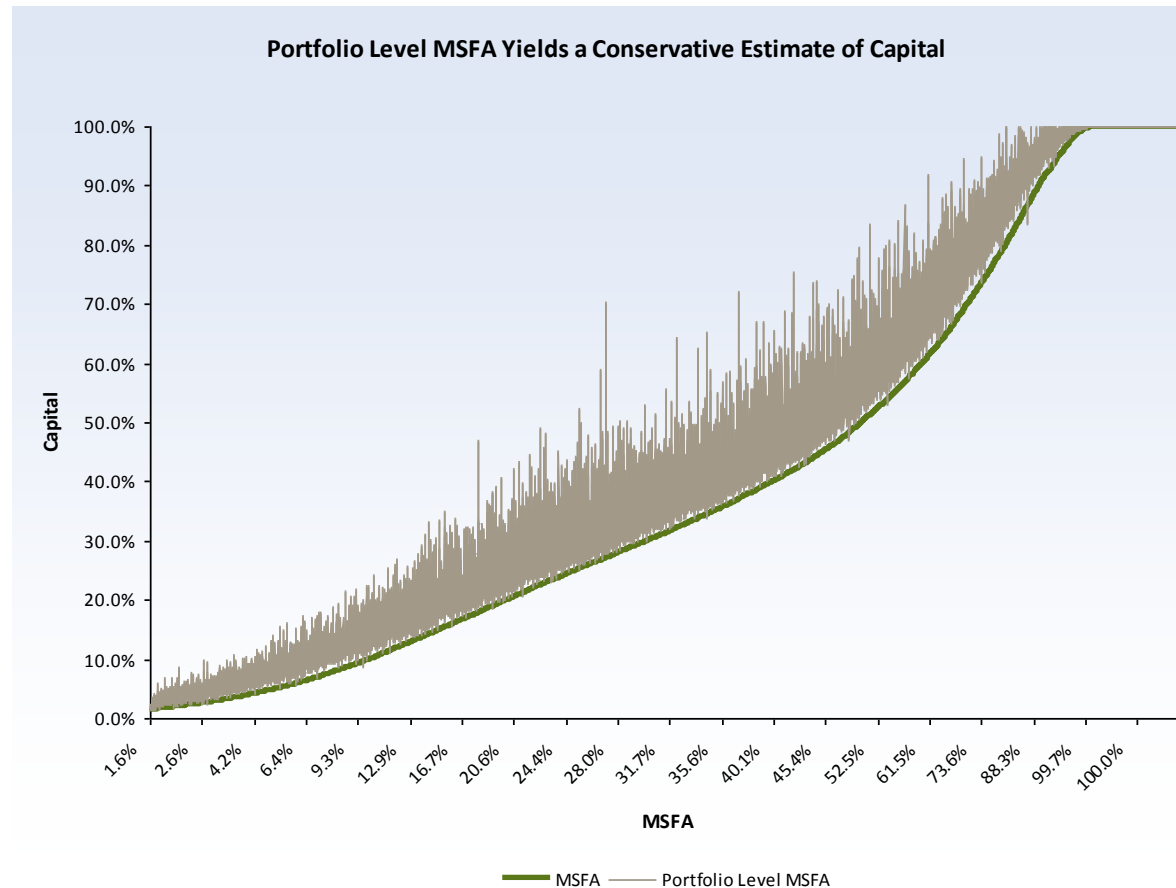
allocation than the approach based on calculations done at the underlying asset level).

A bank performed a simulation analysis of 50,000 samples that created random tranches with a wide variety of characteristics as follows:

- 100 underlying exposures with random notional amounts over a 0 to 1000 range
- PD values randomly assigned from 0 to 30% for each of the 100 underlying
- LGD values randomly assigned from 0 to 100% for each of the 100 underlying
- AVC values calculated as a function of the PD values per the IRB approach
- Attachment points varying randomly from 0 to 50%
- Detachment points varying randomly from attachment + 1% to 100%

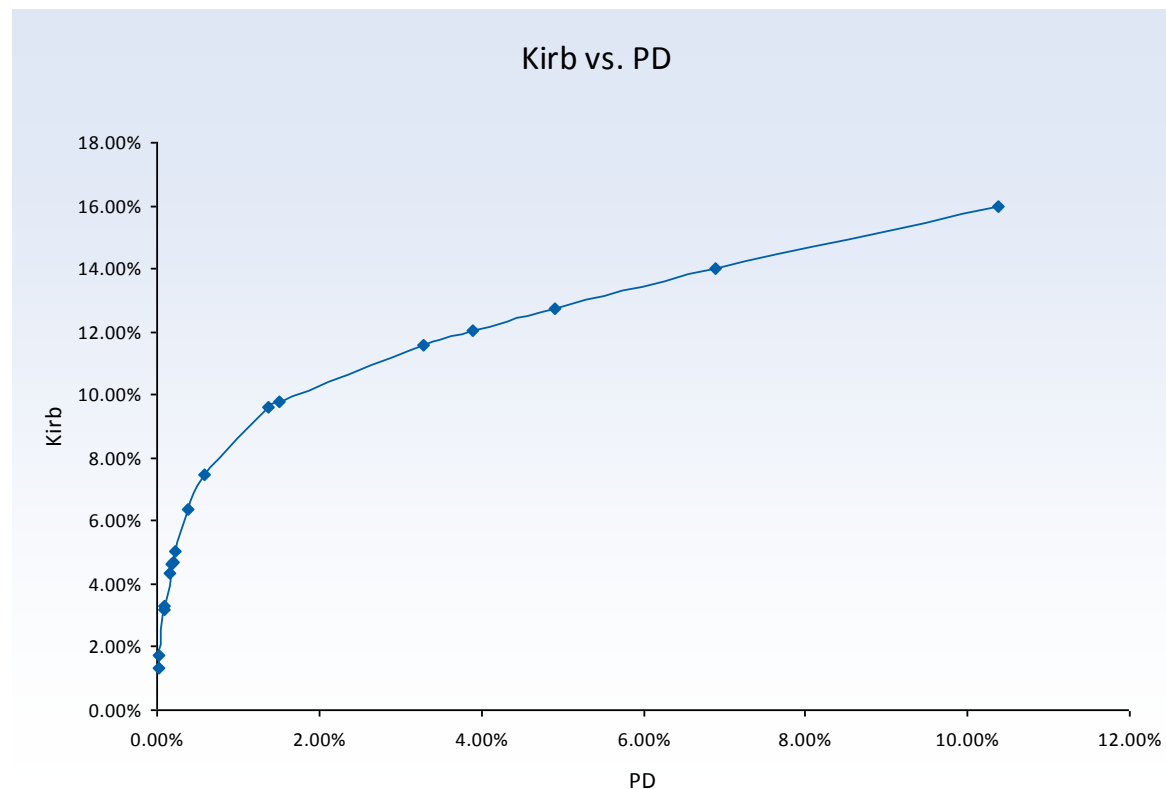
The bank found that in 99.9% of cases, the portfolio level calculation results in a higher capital allocation. The ratio between the portfolio level result and the standard MSFA result averaged 124%. Please see the graph on the next page:

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In addition, a purely mathematical argument can be made on the basis of the relationship between K_{IRB} and the probability of default variable. The K_{IRB} curve levels off as the PD goes up, so the higher risk names contribute "less than linearly" to the total capital (see graph). Or in other terms, the second derivative of the K_{IRB} with respect to PD is negative. As a result, using the average PD can never result in a lower K_{IRB} than the approach where the underlyings are individually analyzed.

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As a result of this relationship, it would seem reasonable to allow sophisticated market participants to make use of portfolio level estimates of PD, LGD and term to calculate the K_{IRB} , and therefore also make use of the MSFA to calculate the regulatory capital for securitization exposures. This approach would have many desirable characteristics:

- does not rely on ratings;
 - requires fewer estimations than the MSFA;
 - requires less modeling than the MSFA;
 - could not be "gamed"; and
 - would promote transparency in the market by creating a demand for timely and accurate portfolio level loss data from the originators.
- This is consistent with the intentions of Reg AB.

To reduce errors, we propose that strict guidelines be put in place on the way banks parameterize the portfolio level PD and LGD estimates.

CBA Members' Comments and Requests for Clarification

Question 9: Is it prudent to allow the use of the MSFA by banks making use of the foundation IRB approach (i.e. not calculating internal estimates of the underlying loans' LGD)?

- If a reasonable LGD assumption can be made, plugging foundation IRB in SFA/MSFA, should be allowed.
- If a bank is not applying AIRB LGD for similar underlying assets in their portfolio, then its regulator should ensure there are no arbitrage opportunities.
- In the MSFA and SSFA section, the graphical representation does not present a floor and seems to contradict the establishment of the 20% RW floor.
- One of the issues observed with purchased assets for securitization is the availability of data to evaluate advanced credit parameters. The requirement to have sufficient information to estimate IRB capital for all the underlying assets of the securitised pool is simply too restrictive and can't be applied to the securitization environment. The use of proxies has to be considered when available. The information requested by line is not available and would probably cause confidentiality issues for market participant. Data based on similar pools and historical performance is available and will get the bank comfortable with the risk of such a pool. In fact, this process is very similar to IAA which should be considered for such transactions.
- The MSFA is only allowed where parameters for the underlying assets are available; we believe that this should be a bit broader to allow for proxy; under the current SFA, it is not specified that the inputs are at the loan-level, so the ability to use proxies currently exists.

Simplified Supervisory Formula Approach (SSFA) (pages 22 – 27)

Question 10: Is the SSFA (particularly the constant term p) appropriately calibrated? Please provide justification and evidence, to the extent possible, for alternative appropriate levels of calibration?

We need more time to further evaluate the impact of this proposed methodology once the results of the QIS are available.

The definition of “delinquent exposures” (i.e. 90-days or more past due) is not standardized across the industry and is not a Pillar III disclosure requirement. For example, delinquency on some agricultural loans is defined as 60-days or more past due, while delinquency on some auto loans is defined as 30-days or more past due. We recommend the variable “W” in the SSFA formula be amenable to different delinquency definitions across different underlying assets. A 90-day or more definition is too restrictive and may not always be available, particularly when past due data is provided as a range (e.g. 64-95 days past due). Also, the proposed definition of “delinquent exposures” severely and unfairly penalizes certain asset classes that pose little or no actual risk to the investor.

Clarity should be provided on the calibration of the (p) factor set at 1.5, which appears to be more conservative than the one established in the U.S. where the factor is set at 0.5, implying that assets outside of the U.S require higher capital charges.

We believe that the supervisory adjustment factor (p) could be variable based on the different maturity bucket.

CBA Members' Comments and Requests for Clarification**Question 11: Is the SSFA properly formulated or should other risk drivers, such as maturity, be incorporated?**

We need more time to further evaluate the impact of this proposed methodology once the results of the QIS are available.

Concentration Ratio Based Approach (pages 27 – 30)

For some legacy re-securitization exposures, calculating individual pool capital could be a large operational challenge. Could Revised RBA be kept as an option for establishing pool level capital requirements to be used as input to the BCRA? We need more time to further evaluate the impact of this proposed methodology.

(i) Concentration Ratio based on K_{IRB} (CR_{KIRB})

No comment.

(ii) Backstop Concentration Ratio Approach (BCRA)**Question 12: Has the BCRA been appropriately calibrated and formulated?**

Given the conservative calibration of the BCRA, we are concerned about the cliff effect that that could result under Alternative B for investors holding senior tranches that are downgraded from “high quality” and where there is insufficient information to use the Concentration Ratio Approach (or to apply a look-through approach). To help remedy the cliff effect, we have recommended a modification to Alternative B (see response to question #4 above). In addition:

- It appears to be excessively conservative.
- The attachment does not play a role in the approach at all.
- It is contradictory to the maximum capital requirement where securitization capital should not be higher than the capital required for the underlying assets.
- It is unclear how the cap should be applied. Presumably, K_{IRB} cap should be applied to all tranches combined. Should overcollateralization be excluded? If yes, what is considered overcollateralization (OC)? If a bank only owns senior tranche, should junior tranche be considered part of OC?
- To differentiate capital requirement via attachment in a Concentration Ratio approach, some simple qualitative criteria can be added.

Question 13: What factors should the Committee consider in weighing whether the F parameter should be set at 2 for senior as well as non-senior tranches to avoid arbitrage opportunities?

- We believe setting $F=2$ for senior tranches is overly punitive and can result in a capital charge that is greater than owning the entire

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collateral pool on the balance sheet without securitization. Consider the example where an average capital factor on the underlying assets is 8% (i.e. 100% RW on the underlying assets) under the standardized approach, the collateral pool notional is \$1,000MM, and the attachment point on a AAA senior tranche is 35% (i.e. the senior tranche represents the top 65% of the capital structure).

The total required capital on the entire collateral pool under the standardized approach (without securitization) would be $8\% \times 1,000\text{MM} \times 100\% = \mathbf{\$80\text{MM}}$

The total required capital on the Senior Tranche under the proposed BCRA:

$$\mathbf{RW = F \times 12.5 \times K_{SA}/D \times 100 = 1 \times 12.5 \times (0.08/1) \times 100 = 100\%}$$

$$\mathbf{RWA = \text{Notional of Senior Tranche} \times RW = (\$1,000 \text{ MM} \times 65\%) \times 100\% = \$650 \text{ MM}}$$

$$\mathbf{\text{Required Capital} = RWA \times 8\% = \$650 \text{ MM} \times 8\% = \$52 \text{ MM}}$$

If the calibration factor (F) is changed to 2 for senior tranches, then capital on the senior tranche would be \$104MM, which is more than if the investor held the entire capital structure. Hence, setting F=2 for senior tranches is overly punitive as it could violate the “look-through” principle.

- The attachment of the tranche is a critical factor.
- M should be considered similar to other approaches; should compare the RBA non-senior (A+ and below) RWs to see if there is a reasonable alignment.

(iii) Re-securitisation exposures***Question 14: How prevalent and material are securitization exposures backed by mixed pools?***

There could conceivably be many situations where pools are comprised of non-securitization SA and IRB exposures, especially from the perspective of an investor in securitizations.

Question 15: Is the proposed treatment for mixed pools appropriate, or should another approach be employed?

The proposal to require only the BCRA for mixed pools, though simple, would be more conservative and less risk sensitive, especially in situations where only a small portion of the underlying pool is SA. We recommend that the Basel Committee consider permitting a pro-rata CR_IRB/BCRA approach for mixed pools, or permitting a the use of the CR_KIRB or MFSA approach where a very large proportion of the underlying collateral is IRB.

IV. OTHER PROPOSED CHANGES AND CLARIFICATIONS (Pages 30 – 35)**Definition of maturity (M) (page 30)**

CBA Members' Comments and Requests for Clarification

Question 16: Is the definition of maturity appropriate, in light of the Committee's objectives?

- The proposed definition of “maturity” may have a punitive effect on revolving securitization deals backed by short-term assets (e.g. credit cards, trade receivables). The following illustration will make the point:

<p>Commitment period: 3 years Underlying assets: Credit card receivables Weighted-average life of the credit card receivables: 180 days Maturity for regulatory capital purposes (based on proposed definition):</p> <ul style="list-style-type: none"> • Max {Commitment maturity, maturity of assets} <ul style="list-style-type: none"> ○ Max{3years, 180 days} ○ => 3 years
<p>The reason using 3 year as the Maturity is punitive is because deals contemplate triggers, the breach of which will terminate the commitment period. Upon the termination of the commitment period, the credit card receivables will mature in 180 days. Consequently, the Maturity for regulatory capital purposes should be 180 days (as this is the maximum period of time the securitization is exposed to potential losses).</p>

- Additionally, imposing an increased capital cost for maturity of a facility when the underlying assets have short asset lives has the following adverse effects:
 - Encourages credit commitments to be of a shorter duration, which in turn promotes instability and increases refinancing risk; thus, not necessarily achieving the goal to reduce cliff effects.
 - Inconsistency in maturity treatment for non-securitized assets that are held directly by the banks, as M is not explicitly captured under the IRB formula for retail assets.
 - Increase in funding costs of deals resulting in originators shying away from this funding source, and thus contributing to less diversified liquidity sources.
- The proposal specifies that the M is based on the contractual cash flows of the tranche. We would like to clarify that this would include the expected prepayment in the underlying portfolio. The inclusion of the expected prepayment would be consistent with the pricing of public ABS bonds. If this is deemed too aggressive for capital calculation, we propose inclusion of minimum or core prepayment that would occur (or that is observed historically) regardless of the market conditions.

Elimination of requirement to deduct below-investment grade exposures for originators under the SA (page 30)

As this would ensure consistency between the SA and IRB, we agree with this proposal.

CBA Members' Comments and Requests for Clarification**Elimination of special treatment for certain exposures** (page 31)

As this would ensure consistency between the SA and IRB, we agree with this proposal.

Use of inferred ratings under the SA (page 31)

We encourage this practice as it will further align SA and IRB.

Risk-weight floor (page 31)

Question 17: Is the proposed 20% risk-weight floor set at an appropriate level? Please provide justification and evidence, to the extent possible, for alternative levels for the risk weight floor.

A 20% RW floor seems too high in the context of RW for other credit products. This may lead to a disincentive to create AAA tranches as it makes RW consistent with an A/AA corporate credit. This floor makes securitization facilities more consistent with corporate/retail lending, which will increase costs for borrowers and retail consumers. This floor may force banks to reprice/exit corporate lending relationships that rely on the current strong returns of securitization to justify low returns on corporates. Increased pricing to our customers will also increase costs to consumers.

One of the reasons for the 20% RW floor is to be consistent with SA, but for lending exposures, IRB capital is not floored at 20% RW: Under the SA lending capital framework, the minimum RW is 20% (or 1.6% capital ratio), except for some sovereign exposures. Under IRB lending capital framework, the capital ratio for non-sovereigns can be much lower than 1.6%.

Given the SFA and MSFA comparison charts (pages 24 to 26 of the consultative document), the buffer has been built in to the MSFA capital required for a tranche where K_{IRB} (estimated underlying loss) just falls below tranche Credit Enhancement (L) (i.e. $K_{IRB} \sim L$).

- Under SFA, tranche capital is very sensitive to input parameters when K_{IRB} is close to L.
 - When K_{IRB} is below L, SFA capital is at 56 bps floor,
 - When K_{IRB} start to exceed L, SFA capital start to increase, in some cases substantially.
- Within MSFA, the tranche capital floor is only hit when K_{IRB} is quite a bit lower than L. In other words, tranche capital starts to increase from the floor when multiples of K_{IRB} is equal to L.
 - Introducing this buffer moderate the cliff effect observed in SFA.
 - Given the sensitive nature of SFA for tranche where K_{IRB} is close to L, the buffer built in MSFA that moderates the cliff effect is moving in the right direction.
 - The magnitude of the buffer needs to be tested, which may require recalibration of tau and omega in MSFA.

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Under MSFA, tranche capital floor is only hit when multiple of K_{IRB} starts to fall below L. In other words, the tranche capital floor is only warranted when underlying loss is “certainly” not exceeding credit enhancement. The 1.6% capital floor is too punitive.

To gauge an appropriate level of capital floor, K_{IRB} for senior secured loan issued to I-2/AAA rated obligor is used as a conservative benchmark. (Based on PD for I-2/AAA rating is 0.03%, and LGD for senior secured loans is 35%.) Depending on the maturity of the loan, K_{IRB} varies as follows:

Maturity	1	2	3	4	≥ 5
$K_{IRB}\%$	0.48%	0.77%	1.05%	1.34%	1.62%

Suggested the tranche capital floor:

- 56 bps if term to maturity ≤ 2 years
- 1.2% if term to maturity > 2 years and < 5 years
- 1.6% if term to maturity ≥ 5 years

Would the Basel Committee consider criteria for super high-quality/low-risk assets that should not be subject to floor?

Other comments

The proposed recalibration may ultimately restrict the availability of financing at the upper end of the rating spectrum thus displacing credit facilities currently available to borrowers. This does not foster economic growth; and as credit is curtailed, the risk of recession is heightened.

Question 18: Should the risk-weight floor for short-term exposures be the same as for long-term exposures?

While we need more information from the QIS, this approach will increase capital requirements considerably. Our main concern is the large increase of the capital floor required for assets that have continuously performed. In Canada, the market has basically self-adjusted by eliminating all new non-bank sponsored ABCP transactions and “market disruption” liquidity line. Canadian assets securitized in banks conduits or balance sheet performance does not support such an increase.

Short-term exposures such as ABCPs are usually well enhanced and backed by top rated assets in order to achieve an A-1/P-1 rating. Given the short term nature of the notes (most of them have maturity less than 90 days), the credit risk is at a minimum. Therefore, using 20% RWs for A-1/P-1 rated ABCPs is punitive. We believe that the Basel Committee rationale should also be consistent with non-securitization exposures.

CBA Members' Comments and Requests for Clarification**Maximum capital charge (overall cap) (page 32)**

The overall capital charge is a welcome aspect. However, it is only available to the MSFA, as it relies on the capability to evaluate the underlying assets in the securitize pool as if it was not securitized. This assumes that required data are available or that proxies can be used to estimate K_{IRB} and calculate the maximum capital charge.

Maximum risk weight for senior securitisation exposures (RW cap) (page 32)

We agree with the RW cap.

Interaction between floors and caps (page 33)**Question 19: Are the proposed caps and their interactions with the proposed floor risk weight appropriate?**

We agree, since the cap is to safeguard against excessive capital requirements. Given that the capital is set at K_{IRB} in cases where the capital is less than the floor, it is reasonable for the cap to be based on the capital that would be required if the bank held the underlying exposures directly (i.e. superseding floor).

However, if K_{IRB} cannot be calculated due to insufficient information, we believe that there should be alternative caps to ensure that capital is not unduly excessive under SSFA, RBA or BCRA. Please refer to our responses for question 17.

Early amortisation provision revisions (page 33)

Revisions to the capital treatment of securitizations with early amortization provisions are not clear. Clarification is requested on which portions of the current framework are eliminated, retained, and amended. We believe that the Basel Committee should consider a transition period for existing securitizations.

The Basel Committee commented that revolving securitizations with early amortization provisions should be penalized since no risk transfer has occurred. Clarification is required. We believe that the existing rules correctly reflected the economic arrangement of a securitization:

- Risk transfer still does occur with certain early amortization features.
- There is no guarantee that the early amortization features will prevent a loss being realized by the purchaser. Consider a scenario where losses increase significantly (i.e. in excess of the enhancement) and rapidly, in which case there would be no time to repay the purchaser before they experience a loss on principal.

Securitizations are non-recourse and legally the originator has no obligation to act to avoid triggering an early amortization event. The originator

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often holds a subordinated interest in the underlying asset portfolio, which provides an economic incentive to protect the structure. However, in our experience, this voluntary support only continues if the originator sees value in this subordinated interest while losses remain relatively low. Securitization providers still take a majority of the notional risk of the underlying asset portfolio.

Treatment of write-downs and purchase discounts (page 34)

Question 20: Are there other approaches that could provide a more risk-sensitive treatment while still being prudent and operationally straight-forward to implement?

Purchase Discounts: We recommend that purchase discounts be given full capital credit by offsetting the securitization capital requirements by the amount of the discount (subject to a floor).

We request clarification regarding when an exposure is written down or purchased at a discount. Should capital be held on the amount at risk, which would equal the purchase price or carrying value net of write-off, presuming the assets are held to maturity. The remainder (the amount of the discount or write-off) would either not been put at risk or would already be recognized as a loss or reduction in capital.

Revisions to the treatment of securitisation positions under the market risk framework (page 34)

We agree and encourage that regulatory capital arbitrage between trading and banking book should be avoided, and would recommend that the changes made to the banking book should also be enforced for the trading book.

V. KEY ASSUMPTIONS AND THEORETICAL UNDERPINNINGS (Pages 35 – 37)

Question 21: Are the assumptions used in developing and calibrating the approaches discussed above appropriate in view of the Committee's stated objectives? Please provide empirical justification for alternative assumptions to those noted above.

We need more time and QIS data to further evaluate the assumptions used in developing and calibrating the approaches.

Giving no credit for future margin income (FMI or excess spread) does not reflect the economic realities within certain asset classes (such as credit cards). While credit to FMI should be monitored and limited based on stress analysis, it cannot be ignored. Clarification is required on FMI; does "give no credit for FMI" refer to:

- Interest spread earned on the underlying securitized loans is not factored in the K_{IRB} calculation in MSFA, or
- No recognition of the Excess Spread that serves as credit enhancement for the tranches?

Analysis of Systemic Overcapitalization in the Basel III MSFAOverview

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In this analysis, we identify 4 categories of conservatism that give rise to systemic regulatory overcapitalization in the Basel III MSFA calculation.

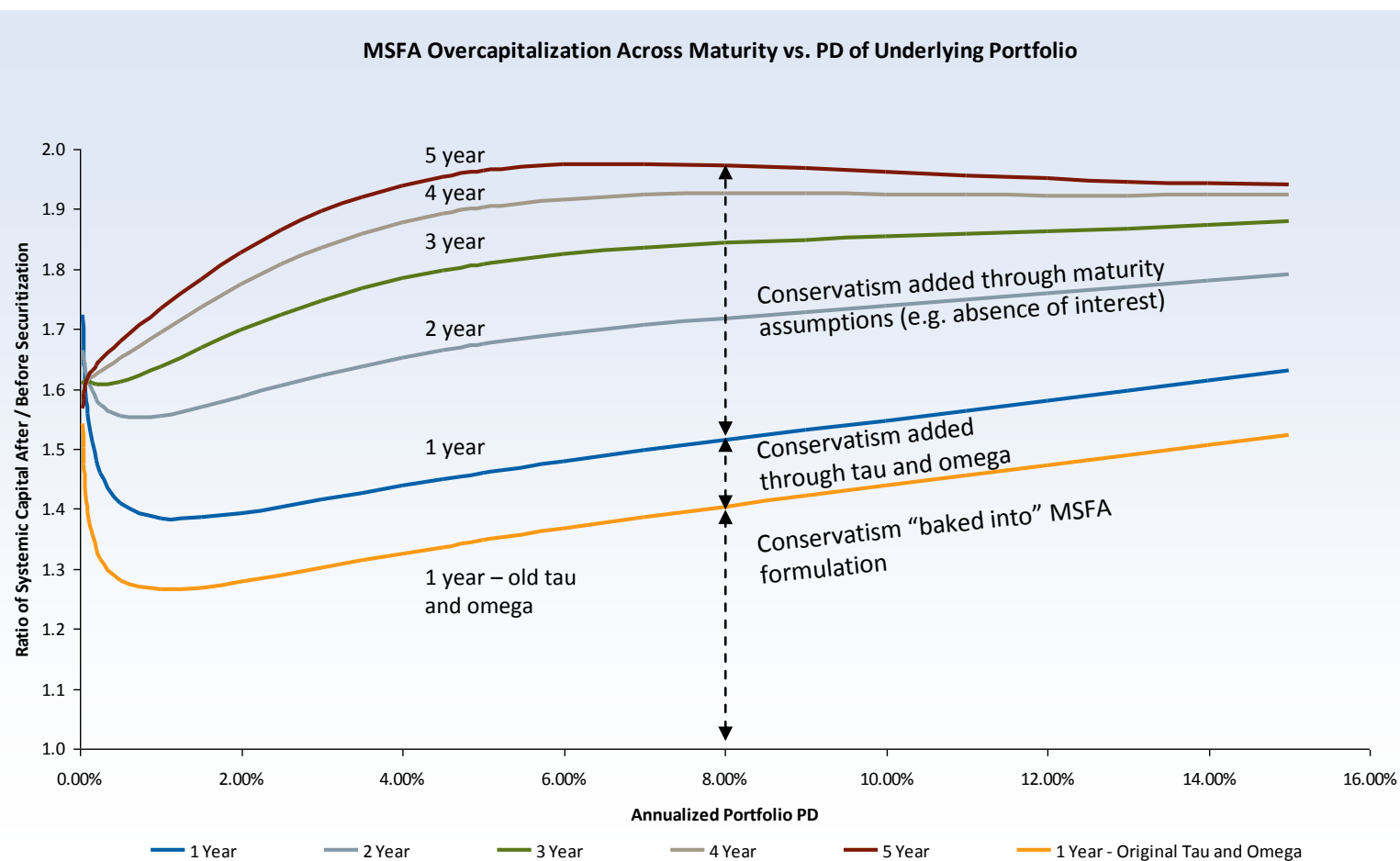
1. Elements "baked into" the MSFA formulation that accumulate through various conservative assumptions, sometimes referred to as prudential add-ons
2. Conservatism added as a result of the re-specification of the tau and omega parameters
3. Conservatism that is a function of the treatment of maturity, likely the result of the assumption that there is no interest income thrown off by the underlying assets after year one
4. Conservatism added by the superimposition of the 20% RW floor

This overcapitalization results in the systemic regulatory capital after securitization being multiples of the capital before securitization, viewed as a sum across the entire capital structure.

Impact of Maturity on MSFA results

Graph 1 displays the result of an analysis taken across a broad range of values for PD, assuming a 30% LGD and before the introduction of the 20% RW floor. The values in the graph represent the multiple of systemic capital (capital after securitization divided by capital before) that results from the implementation of the MSFA. The results describe the impact of three categories of conservatism, those "baked into" the MSFA, the tau and omega factors, and the impact of maturity.

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graph 1

Prudential add-ons appear to be responsible for causing capital after securitization to be at least 1.25 times capital before securitization. The re-specification of tau and omega contribute another 10% increase, and as we go from 1 to 5 years in term, the degree of overcapitalization increases to nearly 2 times. We believe this is a result of the assumption made in the MSFA implementation that the underlying portfolio of assets throws off no interest after year 1. Paragraph 18 of "Working Paper No. 22 - Foundations of the Proposed Modified Supervisory Formula

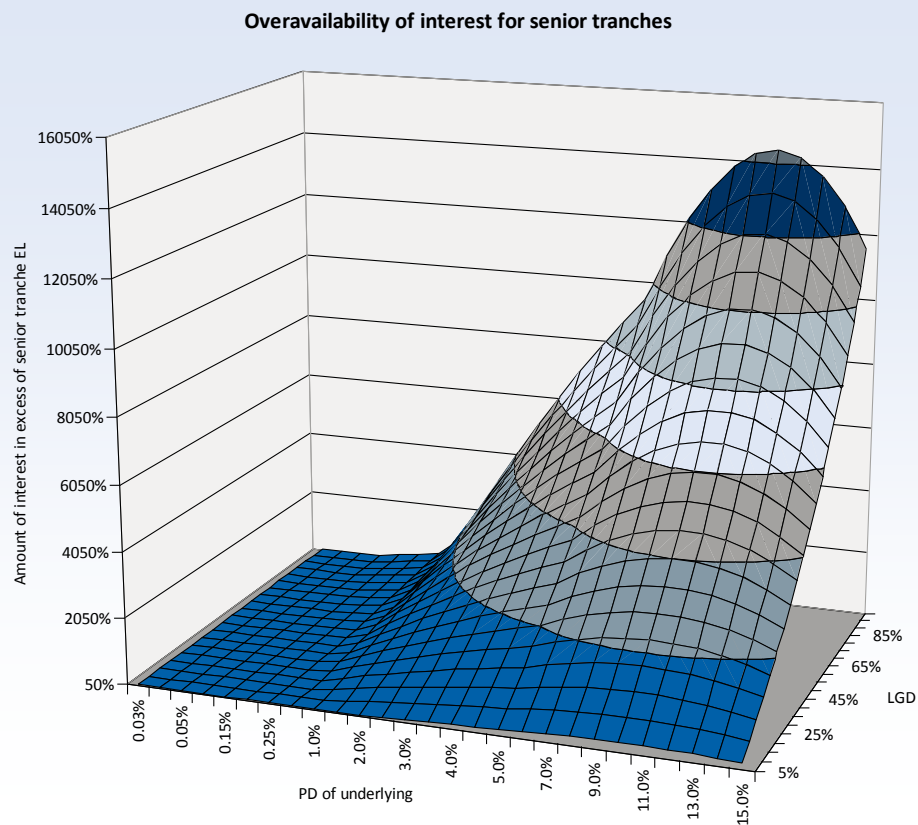
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Approach" from January 2013 includes this text:

... IRB Pillar 1 charges assume, in effect, that expected default losses beyond the capital horizon will be covered by margin income or excess spread. This assumption was problematic for many securitisations during the financial crisis, as sharp deteriorations in the underlying pools eroded anticipated excess spread. A key difference between the IRB framework for wholesale exposures and the MSFA framework is that the latter does not provide any capital benefit for excess spread. For maturity exceeding one year, this difference in the treatment of excess spread is one of several reasons why the sum of MSFA charges across all tranches of a securitisation would tend to exceed the IRB charge for the underlying pool, even abstracting from the proposed MSFA's prudential additions.

This assumption is quite conservative and is certainly at odds with the facts of securitization structures as they relate to senior tranches. The senior-most tranches will be the beneficiary of more than their pro rata share of the interest thrown off by the underlying portfolio of assets, far more than enough to pay for the expected losses on those tranches. Our analysis shows a minimum of 70% more interest than necessary to pay for the expected losses of the senior tranche, given the common securitization structures that divert interest to the senior tranches first.

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graph 2

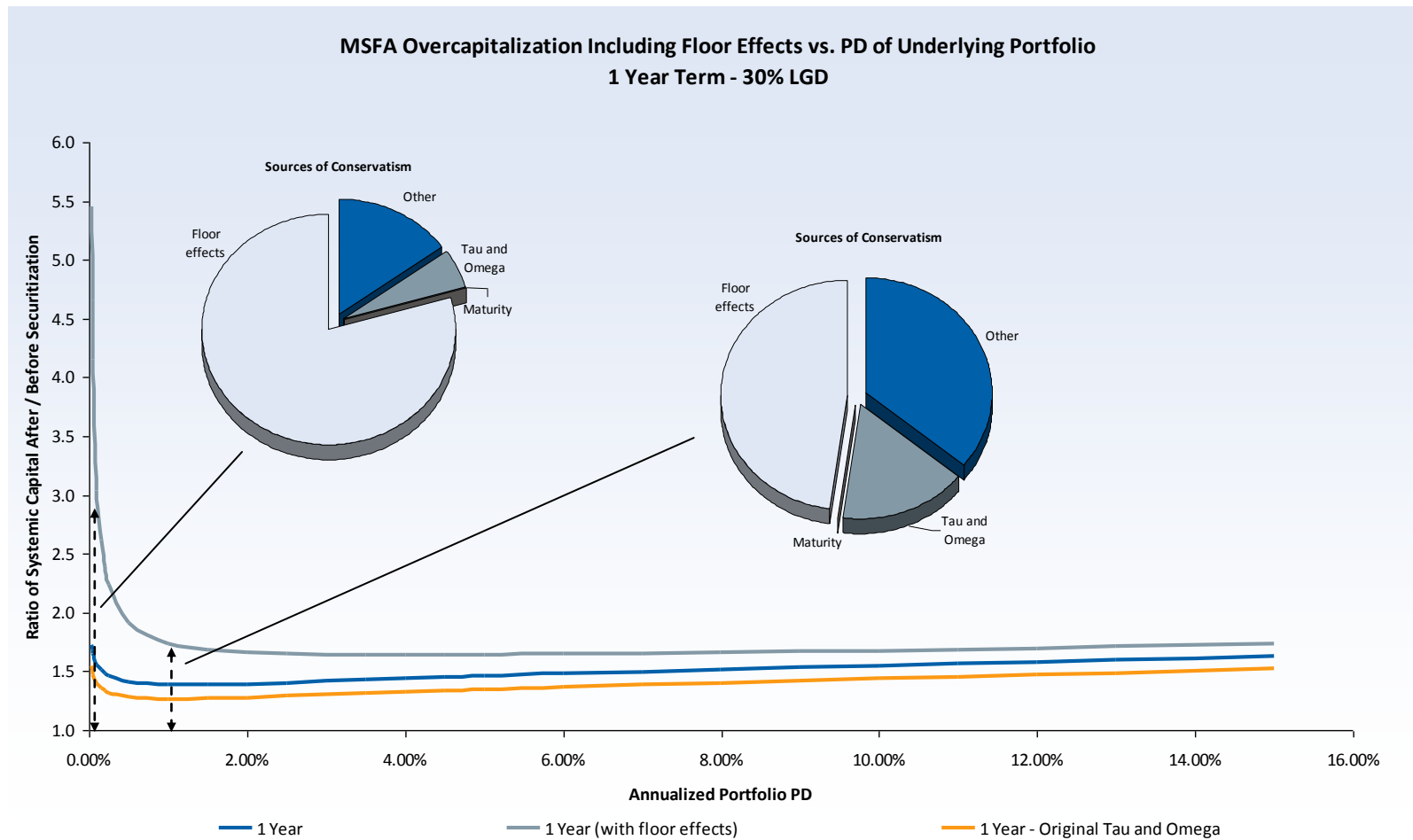
We feel there is strong evidence to support the contention that at least for senior tranches, the assumption of no interest past year 1 be relaxed. This should have the effect of reducing the amount of overcapitalization attributable to the maturity adjustments for these positions.

Impact of RW Floor

Another key source of overcapitalization is the RW floor of 20%. Graphs 3 and 4 extend the analysis to include the impact of the floor and display the relative contribution to this overcapitalization attributable to each of the four elements: Prudential add-ons, tau/omega, maturity and floor. For the lowest risk portfolios, the floor becomes the driving factor to overcapitalization multiples that can exceed 10 times. Graph 3

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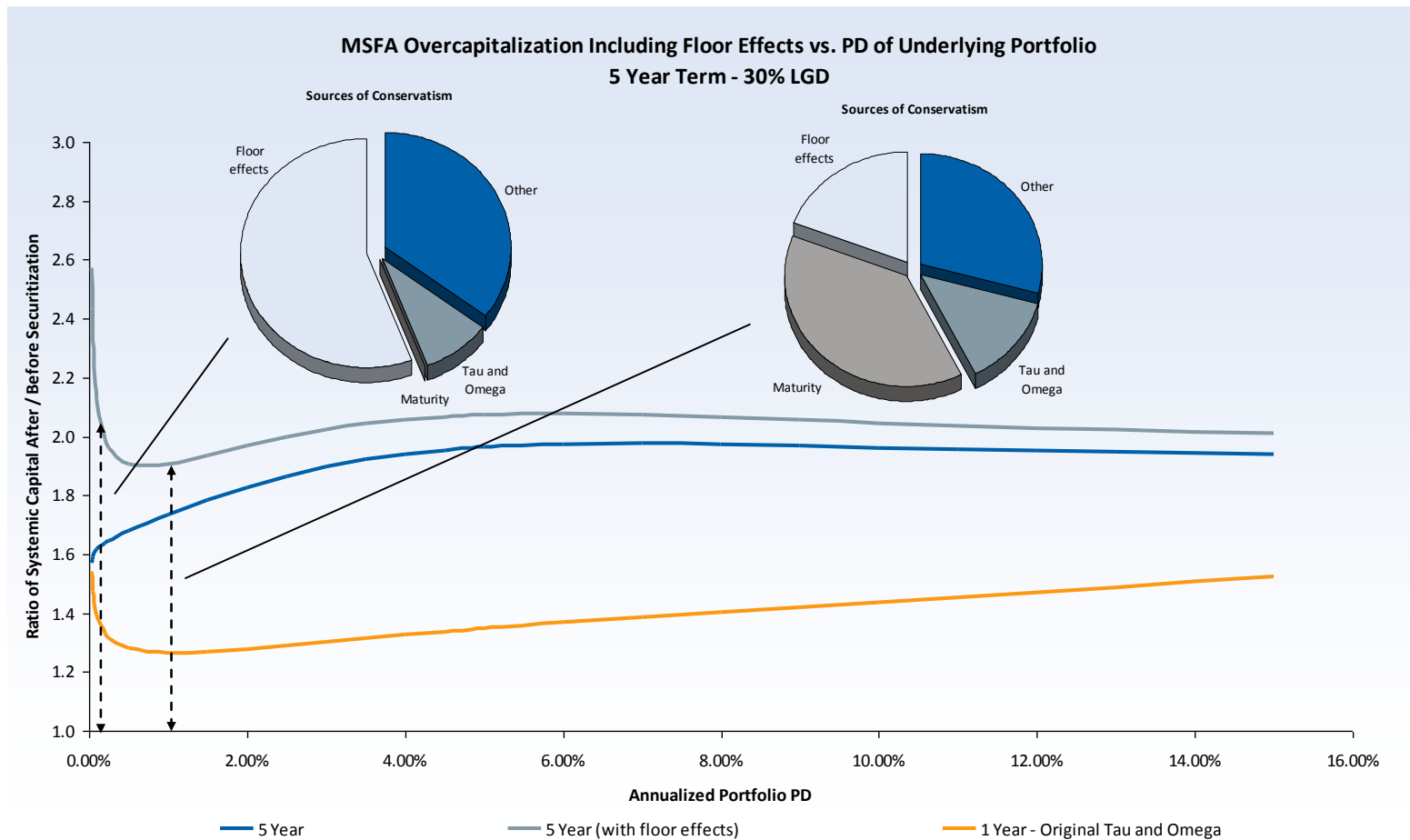
shows these effects for a broad spectrum of PD assumptions at the 1 year point, assuming a 30% LGD. The floor dominates the results.



graph 3

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Graph 4 displays the impact at the 5 year point, where the floor has less of an impact, due to the inflation of the results that can be traced to the maturity assumptions.



graph 4

Conclusion: The analysis would tend to support the proposal to relax the assumption of no interest generated past year one, at least for the senior tranches of securitization. In addition, the analysis suggests that results are distorted for the lowest risk portfolios by the imposition of the 20% floor, generating systemic overcapitalization on an unrealistic scale.

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Question 22: Is the proposed treatment of retail securitizations using the same approaches as for corporate securitizations appropriate? Would additional complexity (in the form of an additional formula to adjust the AVCs of retail underlying exposures) be justified to remove the double-counting effect of maturity effects?

We need more time and QIS data to further evaluate the proposed treatment of retail and corporate securitizations.

- We question using the PD and LGD based on average historical default rate for corporate bonds having an external rating of “B”.
- Many securitization deals are backed by retail pools, so we are uncertain why they are benchmarked against corporate exposures.
- Two “A” rated deals – one backed by “B” quality underlying and another by “BB” quality underlying – may require the same capital because the equalizer is the credit enhancement (which is based on the historical performance and the stress tests).

Question 23: How could concerns that securitised retail exposures have high default risk or high correlation be managed? Please provide data supporting any modifications to the proposed approaches, particularly the MSFA and revised RBA, to account for differences in risk based on underlying exposure types.

We need more time and QIS data to further evaluate possible modifications to the proposed approaches.

Retail securitisations (page 36)

Calibration using corporate loan losses and information is extremely punitive and QIS should be used to calibrate the approach for retail exposure. For some Canadian assets, the calibration of the RBA approach becomes too onerous due to the market structure, related asset guarantees, and collateral used in the structures.

The Basel Committee used assumptions based on underlying corporate loans exposures and that haircut may be justified for retail exposure, although it was not material enough to incorporate adjustments. In the Canadian ABCP market, corporate loans represents only 22.5%, therefore not adjusting for retail assets would be very punitive and harmful to this market. This exclusion of retail assets in the analysis can explain the high floor suggested and our difficulties with such numbers.

VI. CALIBRATION OF THE PROPOSALS AND PLANNED QIS (Pages 37 – 38)

Question 24: Is the relative calibration of the approaches appropriate? Please provide empirical data to support any conclusions.

With Basel III changes in the actual treatment of the unrated assets (i.e. deduction to RW of 1250%), the application of the 6% scaling factor to these assets does not make sense. The 6% scaling factor was included in the calibration of AIRB models, where internal assessment for credit factors are performed by the banks. However, even though the RBA approach is considered an advanced approach, the RWs are calibrated and provided by the regulators. In the case of the 1250% RW, including the scaling factor makes the capital charge higher than the actual exposure.