



Letter to the Basel committee regarding the consultative document issued March 2013 entitled "Recognising the cost of credit protection purchased"

Background of our firm

In the interests of disclosure, our firm World Trade Capital Partners LLP and its related companies have the objective of assisting banks to manage their regulatory capital requirements using private investor capital to protect risk tranches of their Trade Finance asset portfolios via securitisation.

Responses to issues raised in the consultative document

Q1: In addition to the 150% risk-weight threshold, should additional exemptions for certain types of transactions be considered? In particular, the Committee welcomes feedback on (1) exposures guaranteed by governmental entities (including sovereigns and public sector entities) and (2) trade finance transactions with guarantees.

A1: As our firm focus is solely on Trade Finance backed securitisation, we cannot comment on exposures guaranteed by governmental entities. As to the latter half of the question, we see no problems with the 150% risk-weight threshold including Trade Finance transactions with guarantees. Indeed, if an exemption is made for Trade Finance transactions with guarantees, we envisage a difficult scenario whereby one party may claim a transaction falls under that categorisation whilst another claims the contrary. Insofar as we know, systematic, absolute and universal categorisation of what constitutes Trade Finance with guarantees and what does not varies depending on to whom one is speaking, and therefore is neither systematic, nor absolute, nor universal.

Secondly, we do not necessarily believe Trade Finance transactions with guarantees warrant any exemption from regulatory requirements. Although some may argue, with justification, that the default profiles of such transactions are significantly improved when compared to other forms of commercial debt, mention is rarely made of the decreased liquidity of such instruments.

Q2: The Committee welcomes feedback on all aspects of the proposed changes to the rules text and the supplementary technical guidance.

A2: We support the committee in its proposed changes to the credit risk mitigation framework, however we question some of the wording of the consultation document, and would request the committee seek to establish greater clarity on specific items.

Specifically in the section with regards to recognising spread income, the wording in the consultation document reads "Some supervisors may conclude that spread income could be taken into account when calculating the present value of material credit protection costs." We believe this to be a critical issue, and for the regulatory changes to be effective, it must be worded such that all supervisors must conclude that spread income must be taken into account when calculating the present value of material credit protection costs. From our understanding of the matter, this is the "acid test": If premia exceed the spread income of the protected pool of assets in a securitisation, then the only motivation for an institution to transact on such terms would be to defer a loss, the premia cannot be correct for the risk transferred, which is the scenario the consultation document intends to prohibit. If however premia paid are less than the spread income of the pool of protected assets, then the securitisation makes economic sense – the risk

WTCP LLP

Is a Liability Limited Partnership
authorised and regulated by
the Financial Services Authority

Registration Number

Registered in England and Wales
OC371908

Registered Office

One Connaught Place
London W2 2ET



or a portion thereof on a pool of assets is being transferred for the income or a portion thereof earned on the underlying assets. Should a supervisor choose to disregard spread income as mentioned as a possibility in the consultation document, then securitisations where risk transfer is the primary objective (and not loss amortisation) will be adversely affected by the changes, and the beneficial existence of transactions which use securitisation risk transfer to reduce RWA by bringing additional capital into the system will be jeopardised.

There is an undeniable level of complexity in determining spread income, particularly when the securitised pool is large, containing numerous obligors, and in some cases dynamic, replenishing constantly over time, but we remain assertive that to correctly identify securitisations which are incorrectly priced for the risk transfer involved, spread income must be the first filter applied.

We trust the committee appreciates the above brief feedback on the consultation document, and we welcome any further communication from them in this matter.

Sincerely,

The Partners of World Trade Capital Partners LLP.

World Trade Capital Partners LLP,
One Connaught Place,
London W2 2ET

Tel: +44 (0)2036177600

Email: members@wtcp.co.uk

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authorised and regulated by
the Financial Conduct Authority

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Registered in England and Wales
OC371908

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One Connaught Place
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