Position paper on the second consultative document "Fundamental Review of the trading book: A revised market risk framework" (Bank for International Settlements)

Berlin, 31st January 2014

Verband der Automobilindustrie

VDA represents more than 600 companies of the automotive industry including autobanks (so called captives). We are observing with great care the actual banking regulations, which define new disciplines for the financial industry coupled with some potentially negative effects for the real economy. One important element of the new regulatory scheme are rules for securities including ABS, which are also issued by our captives.

First of all, we welcome the fact that the Basel Committee is not further pursuing the "valuation-based approach" proposed for discussion in the first consultative document and is retaining a delineation between trading book and banking book on the basis of stricter framework conditions through the "revised boundary approach". This will continue to enable those institutions that do not currently operate a trading book to avoid implementing the significantly more elaborate trading book requirements within the framework presented by the Basel Committee. Thus, it is in accordance with the principle of proportionality.

Although the trading book regulations have less of a direct significance for captives in the automobile industry, a greater indirect relevance becomes evident as regards the **refinancing of the captives through asset-backed securities**. Asset-backed securities are an important instrument in the refinancing of receivables from vehicle financing and leasing, which in turn are of great importance for sales levels in the auto industry: Each year, more than 13 million new passenger cars are registered in the European Union. Approximately 60 % of the cars sold are either financed or leased. The captives are an indispensable partner for motor vehicle manufacturers in the marketing of passenger and commercial vehicles. They ensure that the automotive value chain runs smoothly.

The regulations on capital adequacy for securitisation positions in the trading book have a **direct impact on the market liquidity of these financing instruments**. For instance, positions from market-making activities are to be allocated to the trading book. Trading activities in ABS via the trading book support a good market liquidity of this financing instrument. The market liquidity of a financial instrument is in turn important for the attractiveness of a capital investment and thus has a direct impact on the refinancing costs of an ABS.

The higher the capital requirements for securitisation positions are developed in the trading book, the higher is the associated cost of carry. Ultimately, such costs are reflected in the refinancing costs. In view of this, we advocate for a **risk-sensitive design of the capital requirement for so-called Auto ABS** to

avoid disadvantageous consequences for the real economy as the result of higher refinancing costs.

Although no final assessment of the calibration is possible at present, we fear that the capital requirements for Auto ABS in the trading book could rise significantly. We would particularly like to comment on the capital backing requirements for the credit spread risk (CSR) and the default risk in securitisations (H).

Credit Spread Risk (CSR): securitisations

In principle we welcome the approach chosen in the area of securitisations to achieve a risk-sensitive capital requirement through the formation of so-called risk buckets to capture the credit spread risk. It also corresponds to our view that at least the most important ABS segments should be calibrated separately and the rest should be allocated to the residual bucket. However, we are not able to understand why a distinction in the securitisation positions has been made between CDOs, MBS and credit card ABS (cf. p. 70, subsection 115 ff). Yet the Auto ABS segment, which is much more significant in relation to credit cards in Europe and probably worldwide as well, has not been calibrated separately.

Within Europe, **Auto ABS was the most important ABS segment together** with RMBS in 2013. The European Auto ABS market once again reached a record level, with public issuance of €17.5 billion. This is €3.7 billion higher than 2012 and above the levels reached in European before the financial crisis (cf. p. 2 of the City Bank Report). The outstanding quality and the low credit spread risk are also reflected in very low credit spreads (cf. p. 3 of the City Bank Report).

We would therefore ask that a risk bucket also be set up for Auto ABS. Securitisation positions from Auto ABS would otherwise have to be allocated to the residual risk bucket. The capital requirements in the residual risk bucket are significantly higher than in the other risk buckets. Additionally, no risk-reducing diversification effects and hedging effects are allowed in the residual bucket, which further leads to an increase of capital requirements (cf. p. 71, subsection 122).

As a result, for Auto ABS, which are based on highly granular, high-quality receivables secured by motor vehicles, significantly more equity capital must be provided than for corporate MBS or unsecured credit card ABS. In the case of Triple A-rated positions, the gross difference between Auto ABS and MB, for example, is approximately 67% and around 36% between Auto ABS and credit card ABS. The net effects are likely to be markedly higher since diversification

and hedging effects are not recognised in the residual bucket. This is not risk-commensurate. **We therefore request that adequate consideration be made for the Auto ABS segment** – a segment that plays a significant role in the securitisation market.

It does not appear appropriate to us to allow diversification and hedging effects only in the case of securitised corporate receivables but not in the case of securitised retail receivables or mixed retail/corporate receivables pools (cf. p. 39 and p. 49). Especially as regards securitised retail receivables, owing to the high granularity of the securitised portfolios, the unexpected losses are generally lower than for corporate receivables.

Default risk (securitisations)

The assumption of a LGD of 75% for senior instruments made in the consultative document (cf. p. 80, subsection 160) does not seem appropriate to us for Auto ABS. The LGDs for Auto ABS are very low since the securitised receivables are secured by motor vehicles with a recoverable value. As a result, the risk of loss is significantly overstated. We advocate **take into account the significantly lower LGDs for Auto ABS** that result from the collateralisation through motor vehicles.

It appears inappropriate to us that a hedging should be allowed only in the case of securitised corporate receivables but not in the case of securitised retail receivables as is usual for Auto ABS (cf. 80, subsection 162). This approach leads to a penalisation against retail securitisations. We therefore argue in favour of also **allowing hedging effects in the trading book for securitised retail or mixed corporate/retail receivables pools**.

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