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Secretariat of the Basel Committee on Banking Supervision
Bank of International Settlements
CH-4002 Basel
Switzerland
baselcommittee@bis.org

Dear Sirs,

BCBS 269: REVISIONS TO THE SECURITISATION FRAMEWORK

Barclays welcomes the opportunity to comment on the Basel Committee's Consultation Document "Revisions to the Securitisation Framework" (BCBS 269). We recognise the further work that has gone into developing the regulatory framework for securitisation since the responses were submitted to the Basel Committee's previous consultation on this topic and are grateful for the opportunity to comment further. Appendix 2 to this response is confidential and should not be published.

Our key messages are detailed in this letter with further detailed comments and answers to the three questions asked in Appendix 1.

We have also contributed to the Joint Associations[1]' response and agree with many of the comments made in that response, in particular regarding the real economy need for securitisation, calibration of capital requirements and more flexible use of IRBA.

Changes to calibration are welcome and more could be achieved to support the principle of risk sensitivity

We are grateful for the further work that has been undertaken on the proposed capital framework for securitisation and welcome the changes to the hierarchy of approaches, the revised floor, introduction of the risk weight caps and clarification on the use of inferred ratings. We remain supportive of the BCBS attempts to make the securitisation framework more risk sensitive within the framework of the key objectives and principles articulated in the consultation paper. We also recognise the efforts of the BCBS to work with the industry in producing an improved framework and look forward to continuing to work with the BCBS as the framework develops.

However, in spite of the improvements to the revised framework with respect to its risk sensitivity, we remain concerned that, on average, the overall calibration is excessive because it doesn't differentiate sufficiently between asset classes that performed well during the credit crisis and those that did not. In addition, we remain concerned that the framework still does not achieve an appropriate balance between ensuring that banks hold adequate capital for the risks inherent in securitisation, including those risks that have not yet crystallised, and not hindering the recovery and deepening of the securitisation market.

In particular, we are concerned that the calibration appears to be driven more by a heavy weight on the worst performing securitisations during the financial crisis rather than the full range of securitisation transactions and not sufficiently risk sensitive to those securitisation exposures which have demonstrated a track record of strong performance even during times of extreme stress. This is a view that is echoed by Yves Mersch, Member of the Executive Board of the European Central Bank in a recent speech[2], discussing the necessary requirements for the recovery in SME funding where he stated: *"This is why I have been vocal in supporting the revitalisation of the*

[1] The Joint Associations response is being submitted by CREFC, CREFC Europe, GFMA (*inter alia*)

[2] Speech to the Institute of International European Affairs, Dublin, 7 February 2014.

securitisation market in Europe, which has virtually dried up in recent years. I see this as an important tool to help banks manage the credit risk associated with lending to SMEs. However, for it to recover it is critical that the regulatory treatment of asset-backed securities (ABS) is based on real data and not the legacy of the US sub-prime disaster. We have a very different experience with ABS here in Europe: between mid-2007 and the first quarter of 2013 the default rate on ABS in the EU was only around 1.4%, whereas it was 17.4% in the United States."

Overall, it is difficult to respond fully to the request for comment on the revised calibration without further understanding of the methodology behind its construction. Our understanding is that there is no plan this time to publish a technical paper on the calibration. However, we would highlight the following issues:

- We recognise that the logically desirable objective of capital neutrality is absent even in the Basel 2 requirements and this is a conscious decision on the part of the regulators. Nevertheless, we believe that the penalties inherent in this revised securitisation framework increase the divergence from a capital neutral position and in some cases, can lead to perverse outcomes. We believe that too great a divergence from neutrality reduces the attractiveness of securitisation as a funding tool and will thus be a significant contribution to the factors inhibiting the resurgence of an appropriately functioning securitisation market.
- The proposal to reduce the risk weight floor is welcome. However, the proposed level of 15% is significantly higher than the risk weighting on other AAA assets (for example long dated sovereign bonds modelled with a very conservative LGD would be approximately 10%). Consequently, it may be difficult to determine an AAA attachment point that will generate enough yield to support the capital employed holding the AAA position in circumstances when the cap for senior exposures does not yield a more risk sensitive outcome than the floor.
- We welcome the proposal to permit banks to use the IRBA even in circumstances where the underlying pool is mixed between those assets risk weighted on an IRB basis and those risk weighted on a standardised basis. However, the proposed 1250% risk weight for non-IRB assets is excessively conservative. A 150% risk weight would reflect the highest possible risk weight the assets would receive if not securitised and, as such, we think would provide an appropriate balance between risk sensitivity and prudence, in cases where the pool is predominantly IRB.
- We understand the Committee's reluctance to permit firms to model maturity given the consequences for comparability between banks' approaches. The proposal to use contractual maturity does meet this concern but is not reflective of the risk profile of securitisation exposures. An alternative approach would be to allow firms to determine maturity using regulator set prepayment rates which differed according to asset type and could be calibrated conservatively.
- We believe that the requirement to infer ratings from a subordinate bond rather than a pari passu bond is particularly onerous for firms which provide swaps to securitisation vehicles. Whilst the risk weight cap provides some relief, the requirements for inferred ratings can result in an unfortunate situation in which a swap receives a risk weighting which is significantly worse than the bond to which it pari passu and has an equivalent maturity. We believe that the rating of the pari passu bond should be available for inferring a rating on swaps unless there are particular structural features which would undermine the credit position of the swap counterparty.

With respect to the proposed caps to capital requirements, we agree with the Committee's view that it would be inappropriate for a bank to be compelled to hold more capital after a securitisation than before it. We would also extend this to the principle that where any participant has sufficient information to calculate the underlying capital requirements on the reference portfolio (via IRB or standardised as applicable) the capital requirement should be capped at that level. This will recognise the efforts made in many jurisdictions to ensure that issuers provide sufficient public disclosure on the securitisations that they have issued.

Lack of a holistic approach may hinder recovery of securitisation market

As noted in our response to BCBS 236, securitisation is a necessary source of funding for the real economy. Moreover, the recovery of the securitisation market is regarded as essential by many to ensure funding is made available to corporates and households at a time when other sources of funding, such as that available directly from banks, is less available. This was noted last year by Mark Carney, Governor of the Bank of England, in a discussion about restoring SME lending[3]: "'*a well-functioning securitisation market - does mean more efficient balance sheets for the financial sector as a whole which frees up capacity, which then can have a knock on effect."*

[3] Speech at East Midlands Conference Centre, 28 August 2013, comment was in response to a question on SME funding.

Whilst we understand the imperative for regulators to incorporate a level of conservatism into any framework it establishes, in order to address potential future uncertainties; we remain concerned that the current proposals do not take account of the many reforms, both in regulation and market practice, which have taken place since the global financial crisis. As we noted in our response to BCBS 236, the retention and due diligence requirements that have been implemented in many jurisdictions have addressed some of the fundamental concerns of the originate to distribute model; rating agencies have updated their methodologies to address many of the shortcomings identified and ratings and the use thereof have been regulated in certain markets. In addition, changes to the overall framework – such as the changes to the thresholds for the composition of capital – mean that in general more capital is being held against each exposure than previously. Without a holistic approach to the reform of the securitisation market, there is a risk that the incremental conservatism that each regulation adds will result in it becoming uneconomic for the securitisation market to function, from both an investor and an originator point of view. We would also note that other non-capital reforms – such as to the liquidity framework and leverage requirements - have increased the challenges for securitisation to be an economically viable business line for banks.

This is something that was noted in the European Commission's Green Paper on Long-Term Financing[4], stating "*an important question is whether ... [the] cumulative impact [of the changes in regulatory requirements] on long-term macroeconomic capital formation could be greater than the simple sum of effects of each reform taken in isolation. The challenge consists in achieving the regulatory goals of greater macro-financial stability and global regulatory convergence in a way that minimises any negative incentives for financing productive long-term investment*". In addition it notes: "*One main lesson of the crisis is that appropriate regulation and supervision of the financial sector is necessary to restore financial stability and confidence in the markets. As part of a broader policy response, it is appropriate to ensure that the detailed calibration of the new regulatory and supervisory framework most effectively enables the financial sector to support the real economy, without jeopardising financial stability.*"

We would propose that the Basel Committee recalibrate to recognise these advances and this should also include an add-on for jurisdictions which have not made progress in these areas.

Availability of approaches across jurisdictions

We welcome the Committee's intention to make the IRBA broadly available to firms, in particular for mixed pools. However, we are concerned that the level of supervisor discretion in allowing access to the IRBA may mean that in some jurisdictions it is in practice not available for banks to use. This could result in a scenario whereby banks from different jurisdictions who could both technically qualify to use the IRBA may be using different approaches to the same exposure, with different capital outcomes. This impact could be magnified by the current proposal to only allow originators to use a look-through cap under the ERBA and Standardised Approach. We are concerned about the potential competiveness impact of such a scenario and, again, about the impact on local securitisation markets and comparability of firms across jurisdictions. If there are structural features which prevent use of the IRBA they should be shared and applied consistently across jurisdictions.

I hope you find our comments and suggestions helpful. Please do not hesitate to contact Roger Versluys (roger.versluys@barclays.com or +44 20 7773 2791) if you have any questions or comments on the issues raised in this response.

Yours sincerely,

Meen Adams
Barclays Chief Accountant

[4] Green Paper on Long-Term Financing of the European Economy, 25 March 2013

Appendix 1: Answers to BCBS questions (1-3) and further detailed comments

Question1: The Committee seeks input as to whether the proposed treatment of derivatives other than credit derivatives achieves an appropriate balance between risk sensitivity and simplicity; and welcomes respondents' views on how to improve upon the proposed treatment.

We welcome the clarification but remain concerned with regard to the continuing use of inferred ratings for securitisation derivatives, in particular those that are pari passu to the most senior tranche. This approach does not reflect the credit risk of these positions and the enhancement provided by their position in the waterfall. The divergence between the capital treatment and the actual credit risk of the derivative position is particularly acute when the next more junior tranche has a low rating or the deal itself is unrated. The possibility of using the risk weight cap for senior positions, assuming it is available for derivatives, would provide some easing of the capital requirements for these positions but would still not reflect the benefits of the enhancement provided to these derivatives, given the risk weight would be based on the underlying pool

We would propose that banks should be permitted to infer the rating from the position to which it is pari passu, rather than the next most senior, all other conditions being met. We think this approach would accurately reflect the reduction in credit risk that is provided by the credit enhancement of the position. Further detail on the the limited credit risk the derivative positions are exposed to can be found in Appendix 2 – which is confidential and should not be published.

Question 2: While the formulation of the Internal Ratings based approach is much simpler than the MFSA, the Committee recognises that there may be opportunities to make further simplifications by, for example, eliminating one or more of the four variables proposed to calculate "p", while achieving a degree of risk sensitivity similar to that of the MFSA. The Committee is interested in respondents' views on ways in which to simplify the parameters of "p".

As noted in our main letter, one of our key concerns with the overall calibration is that it does not sufficiently discriminate between different types of securitisation. As such for some transactions; the capital outcome is disproportionate to the performance of the underlying assets and the historical performance of these types of securitisation transactions.

In particular, under the Standardised Approach - the Simplified Supervisory Formula Approach (SSFA) overstates the capital requirements to cover credit risk in many scenarios, such as:

1) Parameter "p"
The reliance on a single unique parameter "p" regardless of asset type and maturity does not adequately distinguish between different risk profiles. Furthermore, a "p" value of 1 for securitisations is excessively high. We regard the value of 0.5 employed in the US capital rules to be sufficiently conservative. The proposed higher "p" value would have an adverse impact in particular on high quality, prime retail securitisations which tend to have a lower attachment points to reflect the lower risk profile of the underlying borrower pool.

2) Perverse Incentives
The decision to set the deduction threshold for a tranche equal to K(A) may create perverse incentives and cliff effects. For example, where a mezzanine tranche is below K(A), its capital treatment is identical to the first loss piece (i.e. 1250% risk weighting) despite there being differences between the unexpected loss inclusive of expected loss of the two tranches. The risk of the mezzanine tranche is priced according to their economic risk which is significantly lower than for first loss tranches.

3) Non-Performing Loans (NPL) – Standardised approach
The "w" factor is very high for non-performing loans which results in high capital requirements. This does not reflect that such loans are already written down to reflect expected losses and as such the risk has already been factored in via a lowering of the capital base. We would tend to regard those pools as having

lower risk after a write-down since the likelihood of further unexpected losses is now lower.

4) FFELP Student Loans
The SA applied to US government guaranteed loans does not adequately reflect the fact a percentage or all of the principal amount is insured by the US government (i.e. FFELP student loans).

To address these points, we would propose the Committee create different calibrations for "high quality" securitisations and other securitisations. "High quality" securitisations could be defined according to set charactertistics, which would be less open to arbitrage than an asset class definition, which is likely to be more subjective.

We would be happy to work with the Committee on establishing these criteria. Potential examples of the criteria are:

- Eligible assets: Underlying assets are of any one of the following types: (i) residential mortgages; (ii) loans to small and medium-sized enterprises (SMEs); (iii) auto loans and leases; (iv) other leasing; (v) consumer finance; and (vi) credit card receivables.

- Excluded assets: Securitised assets do not include credit-linked notes or synthetic exposures.

- No severe clawback: Insolvency laws of originator's jurisdiction do not include severe clawback provisions (for example, permitting recapture of any assets sold within a specified period before an insolvency proceeding).

- Servicing continuity: Transaction documents include provisions designed to avoid payment disruption in case of originator/servicer default.

- No credit impairment: Only assets from borrowers without impairments.

- No non-performing loans: Underlying assets must not be in default when added to the securitised pool.

- Exposures which have a fast pay down in the event that a credit event is called, for example, conduits often finance assets such as dealer floor-plan loans, servicer advances etc which can pay down over a very short timeframe (in the context of ABS) should there be disruption to funding and hence the assets are not to roll.

We believe this approach would create an appropriate balance between the Committee's objectives/principles of simplicity, prudence and risk sensitivity.

Question 3: If respondents favour a pro rata calculation of the maximum capital requirement, the Committee would welcome arguments that justify that a pro rata cap would result in appropriately conservative capital requirements.

Defining "appropriately conservative" is by its nature a subjective task and as such it is difficult to know on what basis the Committee is viewing conservatism. In our view, conservatism should be looked at on a holistic basis and not a requirement by requirement basis. As such, it is hard to ascertain whether any incremental conservatism provided by the pro rata cap is sufficient. One way to view this would be to consider whether the requirements incentivise appropriate risk sensitive behaviour and/or discourages perverse behaviour. For example, the pro-rata calculation of the maximum capital requirement increases the incentive for firms to diversify their exposures to securitisation rather than having significant exposure to one securitisation.

Furthermore, such an approach is not dissimilar from the concentration ratio approach suggested in the previous consultation.

Other issues:

We note below other comments on the proposed framework which are not covered by the three consultation questions.

Risk weight floor We recognise that the previous framework for securitisation combining a 7% risk weight with an overall 8% total capital requirement resulted in too little capital held against some senior securitisation positions. We also welcome the reduction in the proposed risk weight floor from 20% to 15%. However, we still regard this as too high for highly rated securitisation positions. We think an appropriate comparison point would be highly rated sovereigns which under IRB requirements are likely to have a risk weight closer to 10% than 15%. In addition, we would note that changes to rating agency methodologies since the crisis mean that there are effectively more stringent requirements in relation to the attachment point and underlying quality of assets required to achieve a high enough rating to be eligible for the rating floor. At the current proposed level of the ratings floor, firms may find it difficult to determine to an AAA attachment point that will generate enough yield to support the capital employed holding that position.

Maturity As noted in our response to BCBS 236, we do not agree with the proposed approach to maturity, in particular the use of legal final maturity. We believe it to be excessively conservative, even with the cap of 5 years for IRB assets. The condition for using weighted-average maturity of contractual cashflows (i.e. that the contractual payments must not be reliant on the actual performance of the securitised assets) is unlikely to be met by any securitisations as the definition of a securitisation is that the investors are exposed to the payments received on a ring-fenced set of assets.

We recognise the Committee's reluctance to permit banks to use their own cashflow models when determining maturity, not least as this would diminish the comparability of capital requirements between firms. An alternative approach here may be for regulators to set conservative prepayment rates by asset class which banks would then factor into their maturity calculations.

Availability of cap to investors under ERBA and Standardised approach We welcome the introduction of a maximum capital requirement (overall cap) for originators, sponsors and investors who are using the IRBA. We are, however, disappointed that this cap is not available to firms using the ERBA or Standardised Approach when they act as investor. This may cause particular challenges for jurisdictions where IRB permissions are undertaken on a portfolio basis, and so will not have access to the IRBA for all of its assets, rather than a holistic basis. Firms that have fulfilled the due diligence requirements are likely to have visibility on the underlying pool of assets for a securitisation. Where they are unable to fully model a KIRB, investor firms should be permitted to use standardised risk weights to determine the cap. This would be broadly consistent with the approach taken for mixed pools under the IRBA.

Due Diligence requirements – penalty risk weights The requirements set out in section D of the draft rules text requires firms to apply a 1250% risk weight for any securitisation exposure for which it cannot perform the level of due diligence specified in the rules. These rules constrast with the requirements in the current CRR which impose a minimum 250% risk weight, with scope for the authorities to impose higher risk weights. Also, under CRR, the rules specify that penalty risk weights are only applied in cases where the firm cannot meet the requirements for reasons of negligence or omission. We would propose that the Basel requirements mirror those set out in CRR. The CRR requirements have been highly effective in practice. We do not know how the 1250% requirement has been calibrated and believe the existing EU approach of escalating penalties is sufficient.

IAA – availability Over the last few years it has became common for banks to finance clients' sponsored securitisations in the banks' balance sheet instead of their sponsored conduits. Several reasons have contributed to this shift, in some cases due to the availability of financing directly from retail customers of the bank and in others as a response to new regulations, such as the large exposure rules issued by the PRA in October 2012 limiting the amount of liquidity a British regulated bank can provide to ABCP conduits.

In many cases there is no difference between the deals that are being funded in ABCP conduits and the deals funded directly on the banks' balance sheet. In fact, in most cases where multiple lenders provide financing to a receivables securitisation transaction, some of these lenders fund this via their supported conduits while some other

provide the funds directly from their balance sheet. Both types of lenders have the same exposure but the available methodology to calculate their capital requirements is different. We ask the Committee to consider extending the applicability of the Internal Assessment Approach to positions funded outside of ABCP conduits as long as these positions comply with the same conditions a current ABCP positions needs to comply to use the IAA.

Timing of implementation We would urge the Committee to ensure that the timing of implementation of the banking book securitisation requirements set out in this consultation is co-ordinated with the implementation of the requirements for the trading book that will emerge from the Fundamental Review of the Trading Book (FRTB). Our understanding is that for both sets of requirements, the Committee currently intends to publish final rules by end 2014/early 2015 with an implementation period of one to two years. This is welcome as we believe that for an efficient implementation of the revised securitisation requirements, it will be important that the banking book and trading book treatments are appropriately aligned. As such, if any delay is required in the development of either framework that also delays its implementation date – we would encourage the Committee to also delay the implementation of the other framework to ensure appropriate alignment of the requirements. To be clear, we are not requesting that the Committee accelerate any of its work on FRTB in order to align with the implementation of the revised securitisation framework. We believe it is essential that such a significant undertaking which has wide-ranging impacts continues to be done in a careful and considered way.