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

Dear Basel Committee members:

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

We appreciate the opportunity to review the Basel Committee's second consultative document, *Revisions to the Basel Securitisation Framework*. We support the efforts made by the Basel Committee to simplify the hierarchy of approaches and make the modeling assumptions behind the calibration more consistent with the underlying credit risk framework. We are also pleased to see that sufficient flexibility has been granted to allow all bank participants (i.e. originators, sponsors, and investors) to have the ability to apply the Internal Ratings Based Approach (IRBA). Indeed, we believe a principles-based approach to the application of IRBA is in the best interest of all stakeholders, and that an ongoing open and constructive dialogue between the industry and the regulators regarding IRBA implementation should be maintained. We do, however, believe that much could be gained by:

1. Having more clarity on where banks and supervisors can be “*flexible in the development of IRB estimates*” in applying IRBA;
2. Ensuring that further re-calibration of the underlying models is undertaken and informed by the outcome of the quantitative impact assessments, particularly as it pertains to traditionally structured (i.e. minimal risk transfer) AAA-rated senior tranches with high quality underlying assets;
3. Allowing the capital treatment of securitization exposures that are currently in place, namely the capital relief on originated funding transactions that are securitized with revolving credit exposures, to be grandfathered; and
4. Having greater transparency on the assumptions used by the Basel Committee in calibrating the revised risk-weights of the different approaches.

We note that not all securitization market segments and jurisdictions generated the same material credit losses for banks and investors. In fact, in many jurisdictions, the principal financial impacts for banks and investors were temporary in nature, reflecting the systemic

¹ The Canadian Bankers Association works on behalf of 59 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 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.

reduction of market liquidity across global credit markets, rather than the quality or performance of the assets or securitization structures. In these markets, the existing capital requirements for the senior most tranches has proven to be more than adequate to cover stressed losses both during the credit crisis and in the 4 - 5 years thereafter.

The major differentiators of jurisdictions that did not experience major losses from securitization compared to jurisdictions that did experience losses from certain segments of the securitization market were two-fold:

1. The securitization structures were traditional in nature such that, after factoring in the risk retention prevalent in these structures, there was minimal risk transfer from the originator. Hence, there was an alignment of interests among the collateral originators and the investors in the securitization transactions.
2. The assets underlying the securitization structures were of very high quality and experienced very low default rates (e.g. prime conventional residential mortgages and auto loans).

It is also worth noting that the losses experienced by banks during the financial crisis were predominately generated by subprime residential mortgage backed-securities (RMBS) that didn't benefit from current risk retention guidance and some leveraged collateralized debt obligations (CDO) structures. We submit that the new proposed framework needs to recognize the root causes of this differentiation of both asset quality and market structure, and preserve the risk-sensitivity that has allowed the market to adjust and re-focus on the better performing asset types and more traditional securitization structures that have minimal risk transfer. We believe that the Quantitative Impact Study (QIS) will confirm the preliminary assessments already made by Canadian banks: that the revised proposals continue to disproportionately penalize the best performing and largest segments of the market – traditionally structured (i.e. structures with minimal risk transfer) senior exposures to high-quality assets – and by doing so, risk the banks' ability to continue economically participating as a source of credit to this important segment of the economy.

We have provided our comments on some key issues below, and offer a more detailed response on the consultative draft and its three questions in the attached appendix.

Risk Sensitivity Objective

We believe the maturity-scaled floor of 25% (based on a 5-year maturity on a AAA senior tranche under the External Ratings-Based Approach (ERBA)) has been set at a level well beyond what is needed to absorb the worst-case stressed loss experience on traditionally structured (i.e. structures with minimal risk transfer) senior exposures to high-quality assets, and as such, undermines Basel's risk-sensitivity objective. As a consequence, in our view, the Basel Committee fails to strike the important balance between risk sensitivity and simplicity of implementation. We encourage the Basel Committee to re-calibrate the underlying models so that adequate risk sensitivity is achieved in the capital requirement assessment for traditional securitization structures with high-quality underlying assets (such as prime conventional residential mortgages and auto loans). A one-size fits-all capital floor fails to incentivize prudent underwriting, which could result in unintended risk-taking behaviour. At a minimum, risk-weight calibration needs to be set such that a senior securitized exposure attracts a lower charge than if the asset is held by the bank without the support of credit enhancements available to it in the securitization.

IRBA Application

We are pleased to see that sufficient latitude to apply IRBA is being provided to non-originating (e.g. investing) banks that only have access to pool-level data and that can only validate/back-test at the pool level. We welcome a methodology that allows banks to be less reliant on external credit ratings and provides banks with the ability to strengthen their internal rating assessment processes. The ability to apply IRBA will incent non-originating banks to perform their own internal assessments of securitization exposures, which in turn will help enhance their risk measurement and management practices. This, we believe, will ultimately result in a safer and more resilient banking industry.

We view the implementation of IRBA as an ongoing process, and believe an open and constructive dialogue between the industry and the regulators should be maintained. We also believe that obtaining more clarity regarding where flexibility is possible in the development of IRB estimates would be a helpful step in progressing the IRBA implementation process, and can help mitigate potential implementation inconsistencies across jurisdictions.

Furthermore, we note that the proposed calculation for the supervisory adjustment factor “p” could make it challenging for non-originating banks to apply IRBA. Indeed the parameters “N” (i.e. effective number of exposures in the underlying pool) and “LGD” (i.e. weighted-average Loss Given Default of the underlying pool) would require Exposure at Default (EAD) and Loss Given Default (LGD) to be calculated at the loan-level. This loan-level data is not available to bank investors that invest in most traditional, granular ABS, such as retail ABS, RMBS, and small commercial ABS. As we believe it is not the Basel Committee’s intention to require non-originating banks to have the same level of information as originating banks in order to apply IRBA, we request that the “p” factor calculation be modified so that it does not inhibit a non-originating bank from applying IRBA.

Finally, based on early QIS work, there is concern among our members that the current calibration of the IRBA framework will lead to capital results where the application of the IRBA will require substantially more capital than either the ERBA or standardized approach (SA). Implicit in our request to provide further clarity on the degree of allowable flexibility in establishing the necessary parameters is the expectation that the resultant capital will be comparable to, or modestly lower than, the other more junior approaches in the hierarchy. If the clarity requested is not accompanied by careful calibration, the anticipated result is a detrimental regulatory capital outcome where banks will likely be holding more IRBA capital than either the ERBA or the SA requirements. This will create a meaningful disincentive for banks in their efforts to implement the IRBA and undermine one of the foundations of the Basel Committee’s proposal.

We also note that the proposed formulation of “p” has a floor of 0.3 and has no upper bound (i.e. no cap). We believe a floor of 0.3 to effectively account for the securitization model risk is too high considering conservative buffers are embedded within the PD/LGD estimates of the underlying collateral. Additionally, preliminary QIS results have demonstrated that under certain conditions, the “p” parameter can exceed 1.0, effectively more than doubling the required capital in the overall system after securitization compared to the required capital in the overall system before securitization. In order to prevent overly punitive results, we recommend that for senior securitization tranches, the supervisory “p” parameter be capped at 0.6 (such that securitization under the IRBA would increase the required capital in the overall system by up to 60%). We believe a cap on “p” for senior securitization exposures is justified given these tranches attract relatively low risk, are well understood, are less prone to be impacted by model risk than non-senior tranches, and have low loss given default characteristics. The absence of a cap can lead to more instances where required capital is greater under the IRBA than under the ERBA or the

Standardized Approach. This could, in turn, dissuade banks from aspiring to implement the IRBA and undermine a key Basel objective of better aligning capital requirements with risk.

Risk-Weight Calibration for AAA-rated Senior Tranches under ERBA

While we are both supportive and appreciative that the calibration for the underlying models has been revised since the release of the first consultative document, we request that further adjustments be made. In particular, we believe that a 25% risk-weight under the ERBA for an AAA-rated senior exposure with a 5-year maturity is still too punitive. As most tranche maturities are closer to 4 or 5 years (particularly given the proposed definition of Tranche Maturity – please see below) than 1 year, the “effective” risk-weight floor under ERBA is much closer to 25% than 15%. Hence, the true or “effective” floor for banks that apply ERBA will be more than triple the 7% risk-weight floor under the current framework. We believe that the tripling of the floor is overly punitive, particularly when one considers the mock example described in Annex A at the end of this letter. The mock example in Annex A highlights two concerns that we believe demonstrate that the proposed ERBA risk-weights on AAA-rated senior securitization exposures are overly punitive:

1. Total risk-weighted assets (RWA) in the system can more than double after securitization compared to before securitization.

While we understand that the Basel Committee rejects a strict “capital neutrality” premise due in part to increased model risk, we believe the more than doubling of RWA in the overall system (in the mock example - from \$16 before securitization to \$40 after securitization) as a result of securitization is overly punitive. In fact, it can be argued that Bank A in the mock example (i.e. senior tranche investor) should not be required to hold any capital since Bank B is already holding the required capital needed to meet the risk of the underlying. At the very least, we believe that Bank A’s capital requirement should be much less than \$24, so that the total capital requirement in the overall system is reasonably comparative/consistent before and after securitization.

2. The magnitude of RWA required of the senior tranche investor is unreasonably high given the transaction is structured such that the Credit Enhancement (CE) is more than sufficient to cover losses in a tail event. Further, the RWA of the senior tranche investor can exceed that of the originator even when the originator is effectively holding all of the risk.

The mock example illustrates the counterintuitive result that the senior tranche investor could be forced to hold more capital (i.e. \$1.9 of capital or \$24 RWA), than what is required on the underlying collateral (i.e. \$1.3 of capital or \$16 RWA) without the benefit of CE provided by the retained tranche. Further, in this example, the senior tranche investor’s exposure attracts more RWA (\$24) than that of the originator (\$16), despite the originator holding effectively all of the risk. Therefore, it does not appear reasonable for the senior tranche investor (i.e. Bank A) to have such a high RWA.

We believe the mock example in Annex A demonstrates that a re-calibration of the underlying models/assumptions is warranted, particularly in terms of how it impacts traditionally structured AAA-rated senior tranche securitization exposures under the ERBA. Further, we note that lower overall risk-weights for senior securitization exposures under the ERBA would align well with our recommended proposal to cap the value of the supervisory parameter “p” in the IRBA (see above), as both approaches would produce lower capital requirements than would be yielded

under the current proposal, and so banks that can only implement one of the two approaches will not be unfairly advantaged or disadvantaged from our collective recommendations.

Tranche Maturity

We believe tranche maturity based on either final legal maturity or weighted average maturity of the contractual cash flows is overly punitive and not reflective of the actual risk/maturity of the exposure. We note that the definition of tranche maturity can have a material impact on the capital requirement of an exposure. For example, a AAA-rated senior tranche auto ABS bond with a five-year final legal maturity would attract a 25% risk-weight under the ERBA as per the current definition of tranche maturity², but would attract a risk-weight of ~18% if the weighted-average life (WAL) based on expected cash flows was used as the maturity definition. Indeed, we believe that ABS bonds that have final legal maturities that are materially different than their WAL (e.g. auto ABS bonds, which typically have a final legal maturity of five years and a WAL of close to two years) are unfairly adversely impacted by the proposed definition of tranche maturity. We continue to believe that WAL should be used as the definition of tranche maturity for the following three reasons:

1. Banks use WAL as the definition of tranche maturity for both hedging and Asset Liability Management (ALM) purposes. Given that regulators encourage consistency between capital reporting and risk management, we believe that banks should be permitted to use the same prepayment and clean-up call estimates in arriving at capital requirements as they do for internal risk management.
2. The Basel framework encourages banks to develop, enhance, and ultimately rely on internal models for both regulatory capital and risk management purposes. It appears paradoxical to encourage banks to develop sound internal models, and then prevent them from relying on the assumptions underlying these models because the assumptions could have the ability to be manipulated or inaccurate (per second paragraph on page 16 of consultative document).
3. We believe the validity of using WAL is justified by its use as the definition of tranche maturity in the pricing of public ABS.

Should the Basel Committee decide not to apply WAL universally, we recommend that it at least be used as the definition of tranche maturity for all ABS that have underlying assets with a term of 5 years or less, since contractual payments and the prepayment rates for short-term underlying assets are very predictable and not subject to material model risk. At the very minimum, we believe the tranche maturity should reflect either industry standardized prepayment and clean-up call rates (i.e. core/fundamental prepayment and clean-up call rates that exists regardless of market conditions) or regulator prescribed pre-payment and clean-up call rates.

Cap and Credit Risk Mitigation

We are unclear from different sections of the proposals whether paid-in credit support provided by issuers and other negotiated structural protections that provide credit risk mitigation on the underlying assets will get recognized when determining the cap of the underlying assets. This is particularly important to understand in the Canadian bank context where the vast majority of

² Assuming the weighted average maturity of the contractual cash flows cannot be calculated due either to administrative/operational difficulties or certain conditions not being fulfilled.

securitization exposures held have been, and continue to be, senior positions backed by high-quality assets. Model risk (both rating agencies and the bank) related to both stress testing and rating of these exposures has proven to be very low throughout the crisis, as asset pools backing the positions consistently performed well within stress loss levels required to support the initial rating of the exposures. It is expected that the revised 15 - 25% floors set on many of these exposures will continue to exceed the cap. It is the banks' concern that should risk mitigation benefit provided by contractual and funded credit supports not be applied against the cap level that:

- No incentive will exist for banks to negotiate the credit protections (structural, higher seller enhancement) with clients;
- No economic advantage will exist to incent originators of high-quality assets to provide banks and investors with security to support their financing (relative to unsecured issuance);
- Markets (banks, capital markets) will be steered to securitization of assets where the framework offers more risk sensitivity (i.e., lower quality pools where cap > floor); and
- Originators may be unnecessarily charged for excess capital simply because they chose to securitize their assets.

Definition of re-securitization exposure

This issue is relevant for banks that provide both liquidity facilities and program-wide credit enhancement facilities to ABCP conduits. Banks that currently utilize either the Internal Assessment Approach (IAA) or the Supervisory Formula Approach (SFA) assign a risk-weight to the backstop liquidity commitment supporting the securitization exposure in a manner that:

1. Assumes the bank owns the underlying securitization (i.e. there is no conversion factor to reduce the risk weights below direct ownership), and
2. Does not recognize the benefit of structural protections afforded to liquidity providers (e.g. the requirement to not fund defaulted receivables).

In essence, the capital assigned to the liquidity facility is at least as conservative as the capital that is assigned to funding the exposure 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, the sum total of the regulatory capital associated with the liquidity facilities and program-wide credit enhancement facility supporting the ABCP conduit far exceeds the regulatory capital that a bank would be required to hold if it simply guaranteed each and every asset funded by the ABCP conduit. The impact of this re-securitization approach is an excessive and inconsistent regulatory capital requirement when compared to the regulatory capital that would be required for the liquidity facilities (which are treated as if banks owned the related securitization directly on the banks' balance sheets). We therefore recommend that the regulators make it clear in the IAA that when banks provide greater than 100% committed facilities in support of an eligible ABCP conduit that they not be required to hold more regulatory capital than if they were to fully guarantee each of the underlying transactions that the ABCP conduit has entered into (the IAA Regulatory Cap). See Annex B for a mock example of our recommendation.

Implementation/Timing

Grandfathering and a delayed effective date are critical issues for existing securitization transactions. We believe exposures currently held by banks that have been priced and valued in good faith to support existing cost structures should be grandfathered to avoid harmful and

unnecessary valuation adjustments – absorbed either by bank clients through facility re-pricing or banks through material profit deterioration. In particular, we believe that the early amortization provision revisions (page 17 in the consultative document) should only apply to securitizations transactions that are originated after the revised securitization framework has been implemented so that bank originators that have existing ABS/MBS notes outstanding can continue to realize the capital relief from securitizing their revolving credit exposures, which is what was expected/priced at the time of issuance.

It should be noted that a substantial amount of these originated funding transactions that are securitized with revolving credit exposures are expected to remain outstanding at the estimated implementation date of the revised securitization framework, and so we believe that in the absence of grandfathering, the change in capital relief can have a material impact. If grandfathering is not permitted, given the potentially punitive requirements, we believe the implementation date should be extended far enough into the future to allow banks sufficient time to re-adjust portfolios and structures and capital-raising clients to adjust their funding strategies. The absence of grandfathering will create either a drastic increase in bank capital requirements, or a material re-financing of existing securitized asset pools once the new framework becomes effective.

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 "Dave Hamel", with a stylized flourish at the end.

cc: Ian Gibb, Capital Specialist, OSFI Capital Division
Mary Thomas, Analyst, OSFI Capital Division

Annex A – Mock Example

A \$100 pool of uninsured prime conventional residential mortgages is securitized into a 5-year AAA-rated \$95 senior tranche that is sold to Bank A. The remaining \$5 first loss position is unrated and retained by originating Bank B. Bank B is able to apply IRBA and the average IRB risk-weight applicable to the underlying collateral is 16%. Unlike Bank B, Bank A is unable to obtain sufficient granular data to apply IRBA and so uses ERBA and applies a risk-weight of 25% (per the look-up table). Bank A's total RWA from the transaction is \$24 (i.e. $95 \times 25\%$). Bank B's unrated first loss exposure would attract an RWA ranging from \$20 (risk-weight = $400\% \times \$5$) to \$35 (risk-weight = $700\% \times \$5$) under the IRBA framework, depending on the level of LGD and term to maturity. However, as the consultative document correctly states, it would be inappropriate for Bank B to hold more capital after securitizing the assets than before. As a result, Bank B's total RWA for the unrated first loss exposure will be capped at \$16, which is the total RWA that the pool would attract prior to securitization (i.e. $100 \times 16\%$ IRB risk-weight).

Annex B – Mock IAA Regulatory Capital Example

Illustration of Program Wide Credit Enhancement treated as Resecuritization

	Current Basel III Resecuritization	IAA Regulatory Cap
	Language	
Number of securitizations transactions in the eligible ABCP conduit	10	
Mapped rating of securitization transactions	AAA	
Size of each securitization transaction	\$100	
RWA % for each securitization transaction	15%	
Liquidity Agreement Factor	102%	
Total Notional of Liquidity Facilities	\$1,000	
% of program-wide credit enhancement	10%	
Notional of program-wide credit enhancement	\$100	
(A) Calculation of RWA for program-wide C/E		
KSA (assuming 15% RWA for the underlying securitizations)	1.2%	
RW using standardized approach ($p=1.5$)	373%	
RWA	\$373	
(B) Calculation of securitization RWA for the liquidity facilities		
102% x Notional of liquidity facilities x 15%		\$153
90% x 102% x Notional of liquidity facilities x 15%	\$138	
Total RWA (A) + (B)	\$511	\$153

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

CBA Members' Comments and Requests for Clarification

I. REVISIONS TO THE BASEL SECURITISATION FRAMEWORK (Pages 1-3)

Executive Summary (page 1)

- The objectives of setting “*increase risk weights for highly rated securitization exposures*” and “*reduce risk weights for low-rated senior exposures*”, while certainly reducing cliff effects, conflicts with the principle of “*enhancing the framework’s risk sensitivity*”. Floors for asset pools set at levels well above reasonable stress levels (whether 15-25% or 20-58%) are inherently risk distorting.
- The recognition of “*Risk Sensitivity*” as a guiding principle is welcomed. In any capital allocation methodology this should be the central guiding principle, moderated only for simplicity where needed. Where risk sensitivity does not exist, there is:
 - little incentive for banks to negotiate credit protections (structural, higher seller enhancement) from clients;
 - little economic advantage for originators of high-quality assets to provide banks and investors with security to support their financing (relative to unsecured issuance); and
 - steers markets (banks, capital markets) to securitization of assets where framework offers more risk sensitivity (i.e. lower quality pools where cap > floor).
- The revised calibration has moderated the increases presented in the initial consultative paper but capital remains unreasonably high and insensitive to very high quality low risk senior securitization exposures (i.e. continued 2 – 4 fold increase in capital). As we believe it is the Basel Committee’s intention to maintain a viable securitization market recognizing the fundamental importance of securitizations in enhancing liquidity in the banking system, we urge the Basel Committee to recalibrate their underlying models so that lower capital requirements are applied to vanilla-style senior securitizations (i.e. minimal risk transfer) that are in proven low-risk asset classes and meet specific strong structural criteria. The industry will endeavour to work with the Basel Committee to define the asset classes and structural criteria that will ensure lowest risk weights are only applicable to truly qualifying lowest risk securitization exposures.

CBA Members' Comments and Requests for Clarification

- Reasonably conservative standards should not imply zero risk tolerance. Perceived failure of models in certain sectors of market should not drive generic policy for all securitization exposures.

(i) Changes to the hierarchy of approaches (page 1)

- We agree that the hierarchy makes the choices of approaches possibly clearer and that the approaches are easier to implement. However,
 - It still fails to specify the extent of allowed flexibility in the IRBA implementation related to underlying data required to define credit parameters.
 - It will require significant and costly modifications to the capital calculation processes for non-Supervisory Formula Approach (SFA) banks. Proper transitional arrangements and grandfathering rules would be extremely important for the banks that are currently relying on the ratings-based approach to ensure that banks have the necessary information, systems, and processes required by the desired calculation approaches.
- With the Internal Ratings-Based Approach (IRBA) sitting at the top of the hierarchy, the intent is to encourage internal credit assessment.
 - Based on preliminary capital impact of the proposed IRBA and External Ratings-Based Approach (ERBA), IRBA approach produces meaningfully lower capital than ERBA, as such there could be incentive for banks to allocate resources and invest in IRBA.
 - However, the Standardized Approach (SA) could result in lower capital than IRBA, depending on the subject portfolio. This fails to incentivize banks to invest in IRBA. This is in direct contradiction to the effort made in encouraging banks to acquire as much information as possible; to obtain solid understanding of risk involved in underlying collateral; and to form an internal risk opinion on securitizations. We believe that the proposed hierarchy approaches for re-securitizations (SA -> 1250% RW) should also be reconsidered.
 - The Basel SA is more conservative than US Simplified Supervisory Formula Approach (SSFA). This causes a level playing field issue between jurisdictions. In contrast to level playing field issue caused by operational difference in interpreting regulatory guideline, this is a direct result of model design (through “*p*” parameter setting) that can be, and should be, completely circumvented.
- Given the difficulty in obtaining IRB inputs at a loan level, the investing banks may be challenged to use the Internal Ratings-Based Approach for a number of ABS exposures where this information is not available to them and will likely default to the External Ratings-Based approach.

CBA Members' Comments and Requests for Clarification

This does not seem to fit with the Basel Committee's objective of avoiding mechanical reliance on external ratings. In order for investing banks to use the Internal Ratings-Based Approach, we recommend that pool-level parameters be allowed to be used to calculate K_{IRB} .

- We view the implementation of IRBA as an on-going process and believe an open and constructive dialogue between the industry and the regulators should be maintained in order to ensure consistent IRBA application across jurisdictions.

(ii) Changes to calibration and other clarifications (page 2)

- We are pleased with the changes proposed by the Basel Committee; however, while we believe the changes made are substantial, we see opportunity for further discussions and recalibration to more fairly reflect risk observed in the securitization market. We see this consultation as an evolutionary process.

One-size-fits-all capital floor

- The new proposed maturity-scaled risk-weight floor at 15 – 25% (or 1.2% and 2% capital floor) is still overly punitive for the most senior exposures of plain vanilla traditional asset-backed transactions with high-quality assets that performed well through the last financial crisis. We encourage the Basel Committee to consider:
 - Differentiating risk-weight for traditional granular asset-backed securities (ABS), such as retail asset-backed securities, residential mortgage-backed securities (RMBS), and small commercial asset-backed securities vs. other asset classes.
 - Lowering the floor considering that other bank internal management tools (e.g. limit management) are in place to achieve effective risk management.
 - Setting the capital floor based on the credit quality of underlying collateral (i.e. better credit quality underlying assets leads to lower tranche capital floor).
- Perhaps the floor should be based on relative difference between K_{IRB} and CE, as opposed to just K_{IRB} . We believe that it should be based on K_{IRB} only as different level of CE will be factored in tranche capital calculations. Linking the capital floor with K_{IRB} is an alternative approach to defining high-quality underlying collateral.
- The increase to the risk weight implies an A rating for AAA rated asset-backed securities. In other words, the revised framework would generate higher risk weights for securitization, implying 4-5 rating notches worse than that of a secured corporate loan. According to DBRS

CBA Members' Comments and Requests for Clarification

2012 Default Study¹, March 2013 99.88% of AAA rated Global ABS remained AAA over a three year transition (i.e. historical data spanning from 1985 to 2012) as compared to Corporate Bonds at 77.87%². This is indicative of the benefit of credit protection structured in securitizations.

- Most plain vanilla securitizations did not perform as poorly as stated and those that did represent far less than a majority of the securitizations worldwide. Losses came primarily from subprime mortgage, structured finance collateralized debt obligations (CDOs), etc. where clarity in the creditworthiness of the underlying was either poor or not readily transparent. A number of these transactions that experienced losses also did not have substantive risk retention by the originator, which is common in the plain vanilla securitization seen in Canada.
- The most senior exposures of a properly structured securitization meeting a certain minimum threshold of enhancement (asset class by asset class) should attract lower capital than if the assets are held directly to give credit to the structural benefits of the securitization.

Model calibration

- “*P*” parameter could have a substantial impact on tranche capital estimate, yet this is the most unknown in respect of empirical basis for the calibration proposed in the consultative document.
- While the recalibration has reduced the previously proposed level of required capital, we continue to see the “cliff effect” present in the External Ratings-Based approach. In addition, for low rated senior securitization exposures (prior to the application of caps), the capital required by the External Ratings-Based approach yields a much more punitive result than does the Basel SSFA/US SSFA. This cliff effect would be un-mitigated in the case of non-senior positions due to the lack of any caps. For low-rated exposures, we recommend that the risk-weights for the External Ratings-Based approach be more comparable with the US SSFA to avoid “level playing field” concerns for downgraded exposures. Indeed, U.S. banks would be better able to hold these downgraded exposures, whereas non-U.S. banks would try to sell these exposures given the very punitive capital charges, but would likely experience difficulty selling these exposures.

¹ 2012 DBRS Structured Finance Rating Transition and Default Study, March 2013, pg. 14

² 2012 DBRS Corporate Rating Transition and Default Study, Updated May 2013, pg. 5

CBA Members' Comments and Requests for Clarification**SECTION 1 - BACKGROUND** (Pages 3 – 4)**Shortcomings in current securitisation framework** (page 3)

- **Mechanistic reliance on external rating:** Key is to understand the external rating methodology, in cases where the external rating generates substantially different capital in comparison to internal credit assessment, to ensure relevant factors accounted for by rating agencies are considered to override the internal assessment when appropriate.
- **Too low risk weights for highly-rated securitization exposure:** Risk weights are not universally too low for all securitization exposures and more work should be done to analyze where the losses came from. Please refer to the detailed comments provided to “(ii) Changes to calibration and other clarifications (page 2)”, One-size-fits-all capital floor.
- **Cliff effect:** Under SFA-type of framework, a “cliff effect” refers to tranche capital remaining at the floor for certain range of K_{IRB} level (i.e. when $K_{IRB} < CE$); as K_{IRB} increases to credit enhancement (CE) level, tranche capital substantially increases. This cliff effect directly reflects the risk characteristics associated with securitizations – the availability of CE and thin tranche size magnify the risk imbedded in the underlying collateral resulting in sharp increase in risk imbedded in tranches. As such, the cliff effect is observed when K_{IRB} is close to credit enhancement as opposed to over the entire spectrum of CE level. We believe that reducing the cliff effect could inadvertently introduce model risk.

Objectives and principles of the revisions (pages 3 – 4)

- Objectives of setting “*increase risk weights for highly rated securitization exposures*” and “*reduce risk weights for low-rated senior exposures*”, while certainly reducing cliff effects, is in direct conflict with principle of “*enhancing the framework’s risk sensitivity*”.
 - Floors for asset pools set at levels well above reasonable stress levels (whether 15-25% or 20-58%) are inherently risk distorting.
- **Prudence principle:**
 - Degree of model risk has proven to vary materially across different asset types (obligor quality, pool granularity, pool diversification, and obligor type), originator/servicers (degree of demonstrated experience) and geographies.

CBA Members' Comments and Requests for Clarification

- Prudence principle as applied in proposals continues to have most focused impact on the largest, most liquid and stable sector of the market (prime consumer receivables)
- Structural features are not “*impossible to capture in models*”. In fact, cash flow models are designed to demonstrate degree of protection they offer under stressed scenarios. This is a critical complement to capital modeling and is essential to ensuring these aspects get captured in internal credit assessment.
- **Broad consistency principle**
 - We recommend that the following sentence, “*capital charges for a securitisation should be broadly consistent with the capital charges for the underlying pool, in particular for senior tranches*” should be amended to: “*assumptions and approach to determining capital charges for a securitisation should be broadly consistent with those used for determining the capital charges for the underlying pool, in particular for senior tranches*”.
 - Recognition of principles (iv), (v) and (vi) are welcomed, but should not be rendered moot by principle (ii) and Objectives 2 and 3.
- It is encouraging that flexibility in assessing K_{IRB} and usage of best available information for all asset classes are permitted.

SECTION 2 – HIERARCHY OF APPROACHES (Pages 4 – 6)**Revised hierarchy** (pages 4 – 6)

- Refer to comments provided to “(i) Changes to the hierarchy of approaches” (page 1).

SECTION 3 – PROPOSED APPROACHES (Pages 6 – 9)

- **Flexibility in calculating K_{IRB} parameters:** We agree that maintaining the flexibility to estimate K_{IRB} internally under a top-down approach is appropriate. We would appreciate more clarity as to the level of flexibility that will be allowed in relation to available data on the underlying assets of the pool in order to comply with operational requirement under the IRB approach to develop regulatory credit models and parameters. Specifically:

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- Are we referring to flexibility with respect to modelling or data granularity?
- The documents referenced in the passage pertain to the use of external data sources in the estimate of parameters, and the application of top-down approaches in calculating K_{IRB} . We would like to clarify that for assets not originated by the bank, and subject to the same rigorous risk management process as assets funded through the asset backed commercial paper (ABCP) conduits, banks could make use of top-down loss data provided by clients to estimate PD, LGD and EAD for K_{IRB} .

Question 1: 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 see the proposed treatment of derivatives as a good compromise, although we need to do more analysis on this.
- However, we do have concerns on the treatment required where a bank only has a derivative exposure to the securitization, and that no external rating is available to the tranche that is junior to the swap exposure. In this situation, getting the required underlying information to assess the IRBA or SA might not be feasible, leading to a 1250% risk weight on the EAD.
- Depending on the thickness of the most senior tranche that is junior to swap, swap exposure can have very different ratings under the proposed rules. This does not reflect waterfall structure specific to swap breakage cost.
- The treatment for interest rate swaps requires additional consideration and should address termination payments and ongoing payments in the normal course.
- If an interest rate swap is pari passu with the most senior tranche in the capital structure, the guidance requires artificially inflated capital as compared to the senior tranche. This would not work as written because most ABCP transactions are structured with one senior tranche and one unrated equity tranche. We view this risk weight increase (i.e. risk weight of the next most senior tranche) as arbitrary since the net swap payment is no less likely than that of the senior tranche if its payment shares the same payment priority.
- Incorporating mark-to-market (MtM) value of swaps in K_{IRB} numerator may increase volatility of tranche capital substantially. We agree with excluding swap exposure in the calculation of attachment and detachment.
- In cases where MtM value of swaps is not included in K_{IRB} for practical reasons, it should be permitted so long as banks can demonstrate that swap capital is not underestimated.

CBA Members' Comments and Requests for Clarification**Internal Ratings-Based Approach (pages 6 - 8)**

- We assume that for non-originating banks, the principles-based approach described in the consultative document (i.e. penultimate paragraph on page 7 of document) provides sufficient latitude to apply IRBA and does not contradict some of the stringent IRB capital requirements found in paragraphs 390 to 505 of the Basel II Rules Text that are applicable to originating banks.
- We agree that the probability of default and loss given default (PD/LGD) estimates should be calculated consistently with similar AIRB exposures held internally, however the bank should also be able to benchmark its estimates against external data and explore sources of available information on underlying exposures beyond servicing reports. Ultimately, a mosaic of evidence should be allowed to be used as is consistent with a principles-based approach.
- Our understanding is that sufficient flexibility is being granted so that non-originating banks who do not have access to loan-level data can still apply IRBA. If our understanding is incorrect, we note that non-originating banks typically do not have access to the loan level data to compute such K_{IRB} parameters due to the constraints of current market disclosure practice, and so would be precluded from using IRBA. We believe the reference to the 2005 Basel guidance on low default portfolios is meant to exemplify an instance where a principles-based approach is used rather than a prescriptive approach, as well as to endorse the use of multiple supplemental sources of data to meet the requirements to use IRBA. For completeness, however, we do note that the Low Default Portfolio guidance is not directly transferable to investments in securitizations. Indeed, the guidance on low default portfolios is geared for portfolios that lack a sufficient number of historical loss data points. A lack of sufficient historical data does not directly extend to the concern that bank securitization investors have in which they lack sufficient detail (due to a lack of originator disclosure) to determine any of the historical loss data points (due to limited investor disclosure) and therefore are unable to compute any of the K_{IRB} parameters. However, we believe that reference to the 2005 Basel guidance was meant to serve as an example of principles-based approach, and the Basel Committee did not intend for the guidance to be interpreted in a prescriptive and scrutinized manner. We note that the supervisory add-on p factor is to be calculated according to the formula:

$$P = \max[0.3; (A + B \cdot (1/N) + C \cdot K_{IRB} + D \cdot LGD + E \cdot MT)] \text{ (Pg. 31)}$$

We assume that flexibility will be extended to the computation of the “p” factor, which (as described above) requires loan level EAD and LGD in order to compute “p”.

- The supervisory parameter “p” in the IRBA formula serves as an add-on factor that forces total capital across the structure to be higher after securitization than when the underlying assets are simply held on a bank’s balance sheet before securitization. We understand this is

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intended to take into account model risk in the securitization process and the resulting uncertainty in risk attribution across different tranches. The current formulation for “p” is based on a number of inputs and has a floor of 0.3, implying that total capital across the structure after securitization will be at least 30% higher than before. However, the current formulation is unbounded on the high end, and certain combinations of parameters can result in this factor being greater than 1.0, effectively more than doubling the capital. We propose that for senior securitization tranches, the supervisory “p” parameter be capped at 0.6, creating a formulation that would still ensure capital after securitization would be 30 to 60% higher than capital before securitization. These tranches reflect the lowest risk segment of the market, and have low model risk, with well understood, low loss given default characteristics. We believe that they are unfairly penalized in the current paradigm. As a result the revised formulation for the supervisory parameter “p” would be:

$$P = \min[0.6; \max[0.3; (A + B \cdot (1/N) + C \cdot KIRB + D \cdot LGD + E \cdot MT)]]$$

- The proposal states that “banks would continue to be allowed to use the top-down approach under the current framework to estimate internal PD and/or LGDs for purchased receivables”. While we support continuation of the use of the “top-down approach”, it is our understanding that reference to the “top-down” approach (final paragraph in page 7 of consultative document) means that non-originating banks can apply this approach for securitization investments. For completeness, we do, however, highlight the following concerns:
 - The word “continue” could be interpreted to suggest that there is no change in the application of the “top-down approach” from the current framework, where application of the “top-down approach” appears to be limited to retail and corporate purchased receivables. It is also worth noting that for purchased receivables, the bank purchases the actual pool and application of the “top-down approach” involves the bank making its own pool-level parameter estimates. This differs from securitization exposures, where investing banks do not purchase the underlying pool and it is the originator (and not the investing bank) that is providing the estimates for pool-level parameters.
 - The current framework requires IRB risk quantification requirements to be satisfied in order for pool-level parameters to be used under the “top-down approach”. It is our understanding that for non-originating banks, the principles-based approach described in the consultative document (penultimate paragraph in page 7 of consultative document) provides sufficient latitude to apply the “top-down approach” for securitization investments and that non-originating banks applying the “top-down approach” does not contradict the aforementioned IRB risk quantification requirements that would be applicable to originating banks.
- We appreciate the reference made to the 2005 Basel guidance on low default portfolios, which we have interpreted to mean that a principles-based approach be applied to a non-originating bank’s application of IRBA. We recommend that perhaps some of the following guiding principles can be included in the final version of the framework with regard to dealing with limited data and corroborating K_{IRB} for non-

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originating banks:

- A good faith effort should be made by the non-originating bank to obtain data to support its risk quantification processes (risk characteristic information on the underlying exposures to support the segmentation of exposures).
- A good faith effort should be made by the non-originating bank to explore sources of available information on underlying exposures beyond servicing reports.
- A non-originating bank should be able to use its own historical loss experience for similar types of exposures as a source of relevant reference data if available.
- A non-originating bank should be able to demonstrate that its process for determining K_{IRB} incorporates appropriate level of conservatism.
- A non-originating bank's process for determining K_{IRB} must be well documented, independently validated, and empirically grounded.
- When calculating K_{IRB} , a non-originating bank should have a process for benchmarking its estimates against both internal and external data.

Finally, the guidance could also provide an example on how to develop K_{IRB} parameters with limited data.

- K_{IRB} calculations under IRB approach for the wholesale exposures take into account the maturity of the underlying exposures already. IRB formula accounts for the maturity on top of that, so these exposures are penalized for longer maturity twice. Could the Basel Committee consider including maturity in one of these calculations only for the exposures based on the wholesale pools?

External Ratings-Based Approach (pages 8 - 9)

- While we believe the changes to the calibration to be substantial, we see opportunity for further discussions and recalibration to more fairly reflect historical loss observed in the securitization market. We see this consultation as an evolutionary process.
- We believe the calibration results remain overly punitive, in particular when we take in consideration of high-quality underlying assets such as autos, equipment, and credit card ABSs. Proposed risk weights are too high and provide incentive to only structure short-dated transactions, which can increase refinancing risk.

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- We support the change for the number of ratings required for the use of the External Ratings-Based Approach from 2 ratings to 1 rating. We agree with the Basel Committee that requiring just 1 credit rating will help reduce costs and will reduce the use of less risk-sensitive backstop approaches and caps. We encourage national regulators to be consistent with the Basel Committee in this regard so as to not create level playing issues with banks in different jurisdictions (i.e. banks that reside in jurisdictions that would require more than 1 rating could be disadvantaged from participating in transactions that have exposures with just 1 external credit rating).

Internal Assessment Approach (IAA) (page 9)

- 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).
- We request more clarification as to the scope of IAA. In particular, does all of a particular exposure have to be held in a special purpose entity (i.e. conduit) in order for the exposure to (potentially) qualify for IAA? For example, if a bank has \$100 of securitization exposure to entity X with \$70 held in a bank's multi-seller conduit (and receiving IAA treatment) and the remaining \$30 held by the bank but outside of the conduit, can the \$30 that resides outside of the conduit also receive IAA treatment?
- See comments in the "definition of re-securitisation" section of this document.

Standardised Approach (page 9)

- Refer to the level playing field issue raised in section "(i) Changes to the hierarchy of approaches (page 1)".
- *"Capital requirements for securitization exposures using the Standardized Approach would be calculated using the weighted-average standardized approach capital charge for the underlying exposures in the pool"*. What approvals will IRB banks require to use the standardized approach for the underlying exposures?

CBA Members' Comments and Requests for Clarification**SECTION 4 – CHANGES TO THE CALIBRATION** *(Pages 10 – 15)***Overall calibration** *(page 10)*

- We need to stress test whether counting 80% of excess spread would produce reasonable ratings, however directionally this refinement is welcomed given how critical excess spread is for credit card securitizations.
- Does it imply that benefit of excess spread can be recognized in the tranche attachment under IRBA framework? If yes, explicit language should be included in the Proposed Rules Text.

Internal Ratings-Based Approach *(page 11)*

Question 2: While the formulation of the Internal Ratings-Based Approach is much simpler than the MSFA, 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 MSFA. The Committee is interested in respondents’ views on ways to simplify the parameterisation of “p”.

- We will need more information and review before we can respond. Are there any working papers to be released addressing the calibration of the “p” parameters?
- What is the empirical basis for the calibration of “p” parameter? It is difficult to offer a recommendation on how to calculate “p” when we do not know how the calculation was derived,
- The capital results are highly sensitive to the calibration of the “p” parameter, particularly for senior tranches.
- We also note that a negative parameter assigned to K_{IRB} in the “p” parameter calculation implies that higher underlying risk leads to lower “p” value, which is counterintuitive.
- Based on proposed calibration, “p” parameter for non-senior tranche can be lower than senior tranche which is counterintuitive.

External Ratings-Based Approach *(page 11)*

- While we appreciate that the calibration underpinning the External-Ratings Based Approach has been modified and has resulted in lower overall risk-weights, we still believe the risk-weights are too high for exposures with very strong credit ratings (i.e. AA and above). In

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particular, we believe a 5-year AAA senior tranche exposure should attract a risk-weight of less than 25%, particularly when the standardized risk-weight for an AA- corporate exposure (which does not benefit from credit enhancement/subordination) is 20% (per the BCBS June 2006 paragraph 66).

- We also believe the calibration for maturity is still too punitive as it fails to consider credit enhancement and other structural features of the securitization framework. Indeed, as the ABS approaches maturity and the amortization period decreases, the amount of credit enhancement per dollar of exposure significantly increases thereby reducing exposure risk.

Standardised Approach (pages 11 - 12)

- We request that in determining the delinquency rate for U.S. government guaranteed student loans, the final rules explicitly allow banks to exclude the government guaranteed portion (i.e. 97%) of the collateral as well as deferrals of principal and interest. These exclusions will better align the capital requirements with the actual risk held by investors for these positions. Explicit mention of these exclusions would be helpful, even in a footnote, for clarity.
- The SSFA capital charge level is driven in large part by the level of subordination but the approach does not give consideration to credit enhancement such as excess spread. One of the key drivers in the SSFA capital requirement is the level of credit enhancement/subordination where if the attachment point is lower than the K_A , the formula would require 1250% on the part of the exposure below K_A . We find that this can have a perverse incentive of penalizing strong cash-flow driven structures where a lower level of subordination is required. For example, Canadian credit card securitizations typically have lower levels of subordination (i.e. lower attachment points) due to strong excess spread compared to US credit card deals. However, the senior structure in such a Canadian credit card securitization deal would be penalized more under the proposed SSFA compared to the senior structure in the US credit card securitization deal because its attachment point is lower despite the overall risk to the senior structure being similar in both cases. In short, we believe the SSFA unfairly favours subordination over excess spread resulting in a lower capital charge to a senior structure that has more subordination compared to a senior structure that has more excess spread despite the overall risk to both senior structures being equivalent.

CBA Members' Comments and Requests for Clarification**Impact of revisions** (*pages 12 - 15*)

- Given recalibration, attachment required for tranche capital floor is 2-3 times K_{IRB} – conservatism is excessive to cover model risk.
- With model calibrated to reduce cliff effect, where required CE for capital floor is much higher than K_{IRB} , higher and more risk sensitive capital is still achieved by keeping the floor at 0.56%. In contrast to unsecured corporate loans, there are transactions with capital ranging from 0.56% to 1.2%.
- Graphs showing IRBA calibrations provide no illustrative value to Canadian banks given scaling of the y axis. Risk-weights on Bank A's exposures will be those related to A to AAA-rated credits (i.e. 50% and lower).
- External Ratings-Based Approach (Table 1)
 - Risk weights for 'on strategy' target business (liquid, prime, consumer, diversified) are non-economic, and will reduce bank opportunities to support clients that provide this type of credit;
 - Implications: Non-regulated players will fill the gap or banks will purchase whole loan portfolios directly.
- Need more time to assess.

SECTION 5 – OTHER PROPOSED REVISIONS AND CLARIFICATIONS (*Pages 15 – 19*)**Proposed changes and clarifications to current framework retained from original proposal** (*pages 15 - 15*)**(i) Definition of tranche maturity** (*pages 15 – 16*)

- The Basel Committee noted the concerns about the conservatism raised in response to the first draft of the rules, but kept the definition of maturity unchanged. It was noted that allowing weighted-average life based on expected cash flows (WAL) would entail a reliance on the banks' internal models.
- This appears to be an improvement to the current definition which looks only to the underlying asset maturities and not tranche maturity. However, clarity is needed given that the maturity calculations in Paragraph 23 of the proposed rules text indicates that the term includes the bank's commitment plus the longest dated, eligible asset. Does this then measure tranche maturity using those parameters?
- Guidance also does not address transactions like trade receivables where assets are short dated, and which could turn every 30 days and

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repay the tranche in far less than the commitment. In these cases the commitment is conditioned on performance of the assets and could be shortened dramatically if the assets fail to perform as expected.

- We continue to believe that WAL is a better measure of the actual risk of an asset-backed security (“ABS”) exposure than is final legal maturity or the weighted-average maturity of the contractual cash flows. This is evidenced by the use of WAL for tranche maturity when calculating the pricing of publicly-traded ABS determining the hedging for fixed rate structures, and Asset Liability Management. The definition of tranche maturity could have a material impact on the capital charge of a given exposure as can be seen in the case of a five-year AAA-rated auto ABS bond, which typically has a WAL of approximately two years.
- It should be noted that it is administratively cumbersome to calculate an ABS's weighted-average maturity of contractual cash flows (i.e. backing out expected non-contractual prepayments). While the proposal allows banks to use final legal maturity in the event that weighted-average maturity of contractual cash flows cannot be calculated, we believe final legal maturity will result in a tranche maturity that is too long.
- At the very least, perhaps the regulators can set a standard prepayment rate assumption to be applied to WAL rather than having tranche maturity that is devoid of any prepayment assumption.

(ii) Elimination of requirements to deduct below investment grade exposures for origination (page 16)

- While this is a very positive move to reduce the cliff effect, we are concerned that it is at the cost of the highly rated tranches. Calibration now appears to be rewarding higher risk tranches.

(iii) Early amortisation provision revisions (page 17)

- 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

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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 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.
- We request confirmation that in the event that paragraph 24 and 25 regarding operational requirements for recognition of risk transference, that if the conduit complies with 26(a) and 26(b), (i.e. the subordination of the bank exposure does not change in the event of an early termination) that the capital treatment does not change compare to the current approach.
- Some of our originated funding transactions that are securitized with revolving credit exposures are expected to remain outstanding when the revised Basel securitization framework is expected to be implemented. As such, we believe the capital relief on these transactions should be grandfathered (i.e. we believe the early amortization provision revisions (page 17 of consultative document) should only apply to transactions that commence after the new securitization rules are implemented).

Changes to original proposal (pages 17 - 15)

- Risk-weight floor of 15-25% – inherently risk distorting, no incentive for banks to negotiate credit protection with superior credit quality, and steers markets to securitizations where framework offers more risk sensitivity (i.e. lower quality pools where cap>floor).
- Maximum risk weight for senior securitization exposures (risk-weight cap):
 - *“The Committee is of the view that a bank should not have to apply to a senior tranche a higher risk weight than if it held the underlying exposures directly, given the credit enhancement it receives from subordinated tranches.”*
 - This very basic principle should be extended to quantify and reflect in the cap that credit support regulators recognize exists.

(i) Risk weight floor of 15% (pages 17 - 18)

- Estimates used in the bank calculation of K_{IRB} in the SFA already incorporate uncertainty extensively and remains the best way to

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differentiate transactions from one another. The discipline of using all available information requires data from internal bank experience with like assets, external benchmarks (such as rating agencies/other deals/etc.) and transaction/seller specific data. These benchmarks are documented, evaluated and compared. Based on the reliability and comparability of these data sources, prescribed weights are assigned to each and then additional prescribed adjustments are made as applicable for that transaction.

- This leads to conservative estimates that incorporate uncertainty, which better measures the risk of the underlying. Models are regularly reviewed by model risk, internal auditors and regulators.
- The 15% risk-weight floor seems too high in context of risk weightings for other credit products. This may lead to a disincentive to create AAA tranches as it makes risk-weighting 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 re-price/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.

(ii) Maximum capital requirement (overall cap) (pages 18 - 19)

- We believe the final 5 paragraphs on page 18 (including footnote 20) are difficult to fully understand and apply. We request that these paragraphs be made easier to follow and that a clear distinction be made as to which paragraphs apply to the originator, sponsor, and investor. To facilitate ease of understanding, we recommend that mock numerical examples be used to illustrate application of the rules.

Question 3: If respondents favoured 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.

- While we do agree with the pro-rata calculation option as it would be related to the actual exposure retained by the bank, in cases where the bank holds a portion of a tranche rather than an entire tranche, a pro-rata calculation of maximum capital requirements should be allowed at least for senior tranches. The pro-rata should be capital weighted as opposed to exposure weighted as suggested in the consultative paper.

We believe a maximum capital requirement should apply when a bank holds a portion of a senior tranche. In this case, the maximum capital requirement of the senior tranche should be equal to the carrying value amount invested in the senior tranche multiplied by the capital charge

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of the underlying pool. The rationale here is that the senior exposure is always less risky than the underlying collateral (given subordination), and so the bank investor's investment in the senior tranche should never yield a capital requirement that exceeds what its investment would have been if it invested instead in the underlying collateral.

(iii) Maximum risk weight for senior securitisation exposures (risk-weight cap) (page 19)

- We support the implementation of the risk-weight cap. The cap makes sense since the risk of a senior securitization exposure should never exceed the average risk of the underlying collateral.

(iv) Definition of re-securitisation exposure (page 19)

- More clarity in the proposed rules text is required. The consultative paper says that *"an exposure is a re-securitization if the cash flows depend on the performance of the pool of assets that contains one or more securitization exposures"*.
- The rules text does not repeat this concept. If re-securitization collateral is eliminated from the collateral base, it would not be relied upon and the remainder of the exposure could be treated as a securitization.
- While we recognize that the intent is to eliminate re-securitization exposures from banks overall, there are certain long term exposures (i.e. CLOs) with immaterial portions of re-securitization collateral where capital can be 3-4 times if the whole exposure is treated as a re-securitization.
- This re-securitisation definition is particularly relevant for banks that provide both liquidity facilities and program-wide credit enhancement facilities to ABCP conduits where the total notional of these facilities exceeds 100% of the maximum allowable ABCP that could be issued. Banks that currently utilize either the Internal Assessment Approach (IAA) or the Supervisory Formula Approach (SFA) assign a risk-weight to the backstop liquidity commitment supporting the securitization exposure 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 recognize the benefit of structural protections afforded to liquidity providers (e.g. the requirement to not fund defaulted receivables). In essence, the capital assigned to the liquidity facility is at least as conservative as the capital that is assigned to funding the exposure 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, the sum total of

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the regulatory capital associated with the liquidity facilities and program wide credit enhancement facility supporting the ABCP conduit far exceeds the regulatory capital that a bank would be required to hold if it simply guaranteed each and every asset funded by the ABCP conduit. The impact of this re-securitization approach is an excessive and inconsistent regulatory capital requirement when compared to the regulatory capital that would be required for the liquidity facilities (which are treated as if banks owned the related securitization directly on the banks' balance sheets). We therefore recommend that the regulators make it clear in the IAA that when banks provide greater than one hundred percent committed facilities in support of an eligible ABCP conduit that they not be required to hold more regulatory capital than if they were to fully guarantee each of the underlying transactions that the ABCP conduit has entered into (the IAA Regulatory Cap). See Annex B in the cover letter for a mock example of our recommendation. We explicitly considered a number of factors in developing the IAA Regulatory Cap recommendation. More specifically, we note the following as it relates to the IAA Regulatory Cap:

- It can only be applied to ABCP Conduits where the bank has regulatory approval to use the IAA. In this regard, there is no possibility for this cap to be utilized beyond eligible ABCP conduit activities where regulatory approval and oversight is a precondition. As result, there is no risk of unintended proliferation of this cap framework being applied to other re-securitisation exposures or activities;
 - The resultant IAA Regulatory Cap capital would be equal to the required regulatory capital that a bank would need hold if it fully guaranteed each of the underlying securitization transaction entered into by the eligible ABCP conduit. Therefore, the IAA Regulatory Cap capital would be equivalent to the regulatory capital associated with direct ownership of the underlying transactions entered into by the eligible ABCP Conduit creating a capital equivalency framework.
 - Incorporating an IAA Regulatory Capital Cap is consistent with the other regulatory capital caps that are an essential part of the 'Revisions to the Securitisation Framework' proposal. More specifically, the BCBS makes it clear that banks should not be holding regulatory capital for securitization exposures that is in excess of the regulatory capital that would be required if the banks held the underlying exposures directly. The IAA Regulatory cap simply applies the same foundation to the treatment of program wide credit enhancement facilities extended to eligible ABCP conduits;
 - There is no need to make any changes to the 're-securitisation' definition or framework if the IAA Regulatory Capital Cap concept is integrated into the 'Revisions to the Securitisation Framework'.
- The definition/proposed treatment of the re-securitization deals is very punitive: deals that include one or few securitizations in the pool are still treated as re-securitizations. In addition, exposures with lack of granular underlying data will be risk-weighted at 1250% even if they are externally rated, which is a very punitive treatment. Would the Basel Committee consider allowing the use of the IRB approach for the re-

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securitizations when the percentage of the securitization exposures in the pool is below a certain threshold?

ANNEX I – PROPOSED RULES TEXT (Pages 20 – 46)

- In order to provide a comprehensive response to this paper requires significant modeling to assess the impact of these changes and how these compare with corporate loans secured by the same assets.
- Many of the comments in the proposed rules text and consultative paper appear to apply to bank-originated assets and where applicable should be differentiated from those securitizations provided to third party originator/servicers.
- [Para 18]: **Senior Securitization Exposure, Sequential-Pay Structure** - It is not entirely clear from reading the Basel Committee's rule text on "senior securitization exposure" (paragraph 18/page 23 of consultative document) whether time subordination (sequential-pay structure) can be considered as part of a tranche's credit enhancement. Sequential pay structures sustain losses on a pari-passu basis (i.e. pari passu in default) but non-default cash flows are paid in a sequential manner (e.g. The A3 tranche does not get paid unless the A2 tranche is fully paid). There is emerging industry practice (particularly for auto/lease securitization) to include later-pay tranches as credit enhancement in SSFA calculations. We request the Basel Committee to clarify this issue in its rule text.
- [Para 23]: This paragraph states that maturity needs to incorporate the maximum timeframe the bank is exposed to the potential losses from securitized assets. It implies that banks should size M as the commitment term plus the longest maturity of assets that can be put into the deal prior to the end of the revolving period. However, the text also says that the maturity should not be any longer than the tranche maturity. Please clarify. Is it the shorter of the cash flows of the tranche repayment or the assets?
- [Para 24(a)]: Early amortization - We seek clarification of what is meant by significant credit risk transfer in paragraph 24(a). We believe that the existing rules correctly reflect the economic arrangement of some securitization structures with early amortization features. However, if the proposed rules remain, we request confirmation that in the event that paragraph 24 and 25 (i.e. regarding operational requirements for recognition of risk transference) apply, and if the conduit complies with 26(a) and 26(b) (i.e. the subordination of the bank exposure does not change in the event of an early termination), the bank may exclude underlying exposures from the calculation of risk weighted assets (i.e. the originating capital treatment does not change compared to the current approach).
- [Para 52]: We believe that this paragraph should be amended to include cash as provided by the seller/servicer at inception of the transaction. Cash reserves irrespective of source, that are set aside for the benefit of the securitization note holders should be treated

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consistently. These cash reserves should benefit from treatment that is 'as good' or better than overcollateralization given the liquidity of cash to repay securitized debt.

Credit Risk Mitigation treatment

- Paragraph 642 and related Annex 7 (proportional cover approach) provide the capital treatment for Cash Collateral and Guarantee, or Credit Risk Mitigant (CRM) - when CRM covers first losses or losses on a proportional basis.
- Per para 631, if reserve account is funded by accumulated cash flow from the underlying exposures that is more junior than the tranche in question, it can be included in L.
- As a result, three different approaches are applied to account for the benefit of Cash Reserve, Cash Collateral and Guarantee:
 - Cash Reserve, provided that cash flow is funded by cash flow from underlying securitized exposures, is incorporated in L.
 - Cash Collateral and Guarantee are subject to Proportional Cover approach per Annex 7; where guarantor capital is added back in the case of Guarantee.

We are suggesting that the Proportional Cover approach is not appropriate for Cash Collateral and Guarantee that provide first loss protection to tranches as it does not recognize the tranching effect in the payoff structure for securitizations.

- When Cash Collateral and Guarantee provide first loss protection, L of the tranches that benefit from these CRMs should be adjusted where difference between Cash Collateral and Guarantee lies in the guarantor capital being added back in the case of Guarantee.
- This also addresses the methodology inconsistency between Cash Reserve treatment and Cash Collateral treatment. In both cases, it is cash that is available to absorb the losses; whether it is generated by underlying securitized assets or not should not have an impact on capital assessment all else being equal.