

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

Submitted via email: baselcommittee@bis.org

Zurich, March 21st 2014

Credit Suisse response to the second consultative paper on 'Revisions to the securitization framework' (BCBS 269)

Dear members of the Basel Committee,

Credit Suisse AG (CS) appreciates the opportunity to comment on the second consultative paper (CP) on 'Revisions to the securitization framework' published by the Basel Committee on Banking Supervision (Committee) in December 2013.

CS supports the joint response to the CP provided by the Global Financial Markets Association (GFMA), the International Institute for Finance (IIF) and other industry associations. This letter contains CS' feedback on topics of specific relevance to the bank (section 1) and our recommendations related to the questions raised in the CP (section 2).

CS agrees in principle with the shortcomings of the current framework identified by the Committee, in particular the strong reliance on external ratings and the cliff effects in capital requirements. We also agree with the Committee's stated objectives related to the revision, in particular the focus on risk sensitivity, consistency with the underlying framework and simplicity. CS appreciates that the Committee has considered feedback provided on the first CP and has revised some of the approaches and definitions. We however have a few remaining concerns that we would like the Committee to consider in the next revision of the proposed framework.

We would be happy to discuss our findings and recommendations in more detail with members of the Committee at any time, and hope that our feedback is helpful.

Yours sincerely,

Credit Suisse AG



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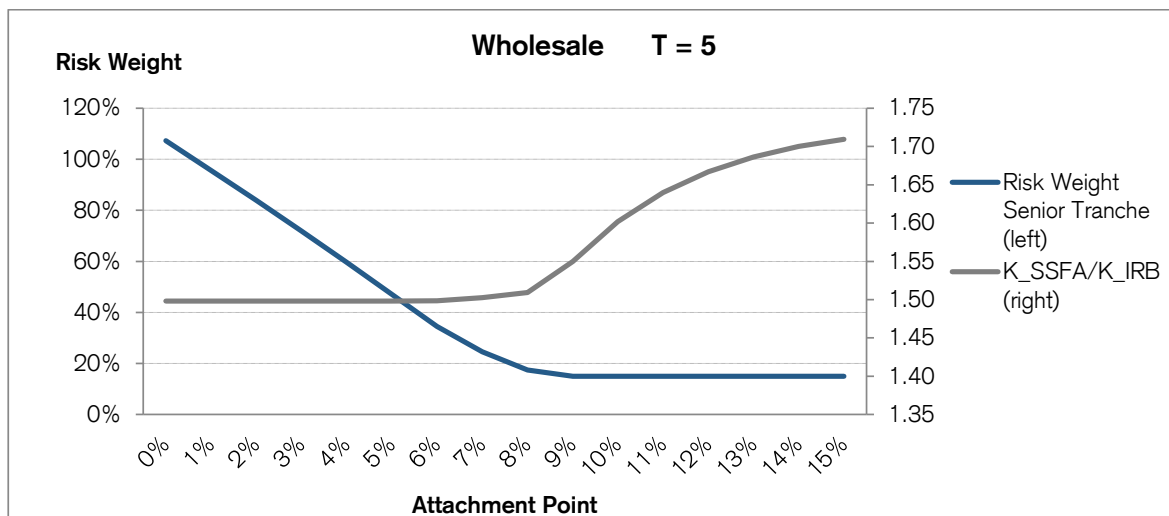
General CS comments

This section outlines CS' general findings and recommendations on the CP. We appreciate that the Committee addressed many concerns raised in response to the first CP. Our feedback includes additional concerns, some of which were previously submitted as feedback to the initial CP but do not appear to have been fully addressed in the revised framework.

Consistency with the underlying framework

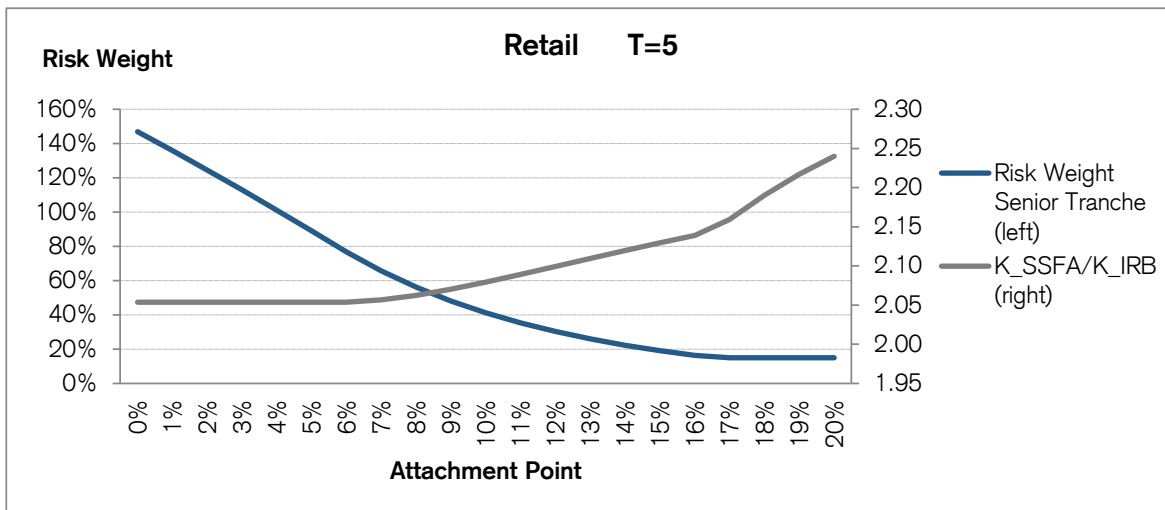
CS considers capital neutrality to be one of the key foundational principles of the securitization framework. Significantly different capital requirements for a single pool of assets when calculated under the proposed approaches both before and after securitization do not reflect the true economic nature of the securitization as the securitization is not designed to alter the risk from an underlying pool of assets but rather to distribute this risk over a number of tranches based upon their seniority in the capital structure. While we appreciate the necessity for the inclusion of a small buffer for model risk in the calibration process, our calculations of vanilla corporate transactions under the proposed approaches show that the capital requirements resulting from the inclusion of all tranches of a securitization are significantly higher than the capital requirements before the securitization. We strongly believe that such inconsistencies between the internal ratings based approach (IRB) for assets held on the balance sheet and the securitization framework are undesirable and create a strong incentive for capital arbitrage that does not exist to the same extent in the current framework.

For example, we analyzed a 5-year wholesale securitization transaction with two tranches on a pool of high-quality assets under the internal ratings based approach to securitizations (IRBA). The analysis shows that up to the attachment point (9% in the example) at which the risk weight floor starts to apply, the capital requirements of all tranches of the securitization are 50% higher than the capital requirements of the underlying pool. When applying a floor of 15% to the senior tranche, the gap widens significantly and the capital requirements of all tranches of the securitization are eventually 70% higher than the capital requirements of the underlying pool.



We performed another analysis assuming that the exact same transaction qualified for treatment under the retail classification. The results show even wider disparities between the approaches. Assuming that the

underlying assets are retail exposures, the minimum attachment point at which the risk weight of the senior tranche reaches the risk weight floor is ~17% (vs. 9% for wholesale). Additionally, at levels up to the 17% attachment point, the capital requirements of all tranches of the securitization are twice as high as the capital requirements of the underlying pool prior to securitization. Once the floor of 15% is applied to the senior tranche, the capital requirements of all tranches of the securitization are eventually 2.25 times as high as the capital requirements of the underlying pool.



We ask that the Committee review the calibration approach in the spirit of capital neutrality with the intent to develop a model that results in better alignment of capital requirements prior to and after securitization. We acknowledge the Committee's concerns with respect to model and systemic risk, but ask the Committee to acknowledge that there are existing measures in place that address such risks. These measures include the proposed floor and various other buffer requirements for systemically important financial institutions.

Calibration of the floor

We agree that a 15% risk weight floor is generally adequate for pools with average or below-average quality assets. For securitizations backed by high-quality pools we ask the Committee to consider the implementation of a lower, flexible floor.

A floor of 15% for a portfolio with an average risk weight of 50% is considerably more punitive than a floor of 15% for a portfolio with an average risk weight of 150%. The market distinguishes between low and high risk portfolios through traded credit spreads against the portfolios. For instance, senior AAA tranches of securities backed by pools of prime mortgages (or prime auto loans) trade at significantly tighter spreads than senior AAA tranches backed by pools of leveraged loans, even though the required AAA-credit enhancement level for a prime mortgage or prime auto loan portfolio is far less than that for a leveraged loan portfolio. We therefore ask that the Committee consider adjusting the floor value such that it be lower and flexible for securitizations backed by high-quality pools.

Given the difficulty for a bank to apply the IRBA for its investments in securitizations where the bank is not the originator (see further below), one can assume that the IRBA and therefore the floor in respect of the IRBA will most likely apply to those exposures retained by the originating bank. Therefore, we suggest that the floor should be expressed as a function of Kirb (rather than being held constant) and that it should reflect (i) the riskiness of the underlying portfolio, and (ii) the overall capital requirement from a securitization. This

would be more consistent with the capital requirement of holding the underlying pool of assets. Otherwise, banks which are exposed to high-quality portfolios would be incentivized to sell the entire risk of such high quality portfolios only to replace it with (senior tranches of) riskier portfolios.

Maturity

For many assets, the legal stated final maturity is far longer than the weighted average cash flow life. Examples of this common phenomena are securitizations backed by residential mortgage loans where the legal maturity of all tranches is generally the longest legal maturity of any underlying loan, which may be as long as 40 years. For a fixed-payment fully-amortizing 30-year loan, if the borrower makes the minimum scheduled payment over the life of the loan, the cash flow weighted average life (WAL) is generally under 20 years. From a securitization perspective, a front-pay bond can be tranching with a cash flow WAL of well under 5 years even if the borrower only makes the minimum scheduled payment. For this bond, the legal final maturity of 40 years, though capped at 5 years for regulatory purposes, is in excess of the cash flow WAL under the most conservative scenario.

From a modeling perspective, simple conservative assumptions can be adopted. CPR as a metric measures the portion of a pool of borrowers who are expected to prepay/refinance/exit the pool on an annual basis. The notion of "0 CPR" assumes 0% of the borrowers exit, and is the equivalent of assuming that all borrowers make their minimum scheduled payment; i.e., there has been no accelerated repayment through refinancing or other activity. This will generally result in a conservative (long) estimate of the pool's maturity, which is more a reflection of the actual risk than the legal stated final maturity. Calculating cash flows at 0% CPR is straightforward, requiring no modeling assumptions, relying only upon the ability to apply cash flows in a structure according to the structure's cash flow waterfall. In the US trading markets, this can be easily done through any of the widely available market data and modeling systems such as Intex, Bloomberg, Yieldbook, or various other 3rd-party analytical tools.

A more realistic suggestion for the Committee would be to require for modeling purposes the choice of a simple but conservative prepayment assumption (e.g., 2% CPR for mortgages, which is greater than 0% but still reflects a very conservative rate of repayment, resulting in a stress extension scenario) for various asset classes. In our opinion this would be consistent with the Committee assigning standardized risk weights or other broad-brush assumptions by asset classes.

For certain other transactions the legal stated final maturity of the tranche is in excess of the maturity of the actual assets underlying the pool. This is most often the case for revolving portfolios. In this case, it is our opinion that using the legal stated maturity for the asset pool is too punitive and does not reflect the underlying risk and cash timing of cash flows within the structure. Our suggestion would be to consider using the weighted average maturity (WAM) of the underlying assets at each reporting date as this better represents the true nature of the cash flows within the structure (since the transaction should not exceed the WAM of the underlying assets itself as the transaction automatically falls away if there are no longer any assets remaining in the pool). While the WAM of the underlying assets of a revolving pool may change slightly over the life of the transaction, this variability can be adequately captured incorporating regular snapshots of the WAM of the underlying pool of assets within the calculation of the risk weight of the tranche at each regular reporting date.

Finally, we would like to note that the maturity is an important data point outside the securitization framework. The calculated maturity of certain derivative transactions reflecting the maturity of the underlying reference asset appears in, for example, the calculation of counterparty credit risk (as longer-maturity derivative transactions attract greater capital than short-maturity transactions). It would appear likely that using the legal final maturity in the securitization framework (rather than a maturity related to forecasted cash flows) will be taken as guidance that credit exposures linked to securitizations should also be capitalized to their full legal stated maturity, rather than as a metric that reflects the economics of the transaction.

Proposed approaches

CS agrees with the Committee that risk sensitivity is a key aspect of the securitization framework. In that regard, CS agrees that the IRBA should be at the top of the hierarchy of approaches. Our main concern with respect to the currently proposed IRBA approach relates to a bank's ability to develop PD/LGD models for all types of securitizations where the bank acts as an investor. While a large bank typically has PD/LGD models for assets where it acts as an originator, it is our opinion that the data availability may be very limited for investors in certain asset classes. As a result, many banks may not be able to develop PD/LGD models unless regulators show more flexibility with respect to the level of details required for modeling certain underlying assets.

However, even if regulators show more flexibility, there may be a need for banks to develop separate PD/LGD models depending upon whether the bank is acting as an originator of an asset class or an investor in a securitization. For example, a bank originating mortgages in a certain market will have up-to-date information on relevant modeling criteria such as the loan-to-value ratio (LTV) or a borrower's creditworthiness, and thus will be able to better model default probabilities. If the same bank invests in a securitization position backed by a pool of mortgages originated by a different bank, it will typically not have up-to-date information on the same criteria. Instead, the bank may have to rely on information gathered at the time of origination of the assets. It is our opinion that developing and using separate models may result in increased operational burdens for both the banks developing such models and the regulators approving them.

We are equally concerned with respect to the treatment of securitization positions held in trading books. Even though a bank might be able to put certain processes in place to determine PDs and LGDs for each of the underlying asset within a securitization, the operational burdens could be significant especially for positions with a high turnover that may only be in a bank's trading inventory for a short time. For example, a bank may have a PD/LGD model for corporate loans and hold a CLO in its trading book. While the bank would be able to determine internal ratings for all counterparties to be used in determining the related PDs and would also be able to assign LGDs to each underlying transaction, the CLO might only be in the trading book for a short period of time. After that, the bank would sell this specific position and potentially buy a different CLO for which it would again have to determine all PDs and LGDs. The analysis that would be required for assets held for a short period of time increases banks' operational risk.

We understand that banks have the opportunity to apply either the external ratings based approach (ERBA) or the standardized approach (SA) in such cases. While we consider the ERBA to be a valid alternative to the IRBA, it may not be available to all banks in all jurisdictions. It is our opinion that the SA is an approach that lacks sufficient risk sensitivity. Under the SA, a significant number of the underlying assets would be assigned a risk weight of 100% to determine K_A , irrespective of the embedded risk. This could lead to banks having an incentive to invest in securitizations backed by high-risk pools.

In addition, it is our opinion that certain risk weights determined under the SA would require banks to model the underlying data. For example, the risk weights for mortgages under the SA, as per the Swiss regulation, are dependent upon the LTV of a position. A bank acting as an investor in the US mortgage markets will only have access to the LTV at origination of the mortgage and will then model the development of the LTV over time based on certain other risk factors (e.g. changes in home prices in a certain area). An open question that remains when viewing this approach is whether such modeled LTVs could be used as the basis for risk weights under an SA calculation, or whether a bank would have to use a default of a 100% risk weight. In such cases, a bank acting only as an investor, would not be able to apply the IRBA. Additionally, the bank acting as an investor would have to apply an overly conservative risk weights under the SA which is not necessarily reflective of the risk of the underlying pool of assets.

Given our belief that many banks acting as investors will default to the SA – especially in jurisdictions not allowing the use of the ERBA – we ask regulators to put more emphasis on an adequate calibration of the

SA. Similar to the IRBA, we think that p should be calibrated differently depending on types of underlying exposures and the seniority of a tranche.

We also recommend that disclosure requirements for securitizations be enhanced so that investors have more readily available data that can be the basis for developing a regulator-approved PD/LGD model.

Impact assessment

We appreciate the opportunity to participate in the ongoing quantitative impact study (QIS) for banking book securitizations. CS, like many other banks, has a significant number of securitization positions in our trading books. It is our opinion that it will be important to perform an impact assessment of the effect of the new framework on securitizations that are held in a bank's trading books. It is our understanding that a QIS with respect to the Basel proposed 'Fundamental review of trading book' (BCBS 265) is planned for the second half of 2014, and we ask that the Committee allow sufficient amount of time for consideration of the results of such a QIS before the final securitization framework is adopted.

CS feedback on specific questions

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 conceptually agree that derivatives entered into by SPEs should be considered when determining Kirb as they can impact the cash flows distributed to investors in the securitization.

CS acts as counterparty to many SPEs and has therefore models in place to determine the value of these derivatives and the associated capital requirements. We consider these models to be rather complex and they require the details of the swap transaction to be available at all times during the life of the transaction as changes in valuations can be significant.

Many (even large) banks are not acting as swap counterparties to securitization vehicles and may not have the incentive to invest in the required models. Even if they did, each model will likely be based on different assumptions and while one model could lead to a positive replacement value of the SPE's derivative, another one could result in a different assessment. In addition, the required information to run a full valuation is often not disclosed to investors in the securitization, ie only the bank acting as the swap counterparty would have access to all relevant details. Even if there were a requirement to disclose all relevant information in investor reports, such reports are not produced daily but rather only on a monthly or quarterly basis, while the value of a derivative can fluctuate significantly over such a period of time. As a result of these considerations we do not think that the treatment proposed by the Committee would meet the objective of simplicity.

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 think that the proposed calculation under the IRBA is sufficiently simple for banks to implement. However, given the distinction between wholesale and retail, we would like to ask for clarification on what parameters would be applied to mixed pools (containing both wholesale and retail positions). For example, such mixed pools can exist if loans to small and medium-size enterprises (SMEs) are securitized, when some of the underlying positions are treated as corporate exposures under IRB while others are (due to their small size) treated as retail exposures.

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.

We think that the pro rata cap is a reasonable and sound instrument to calculate capital requirements for securitization exposures, and it is especially relevant in the context of retention rules that various jurisdictions have defined. We do not think that such a cap would lead to arbitrage opportunities for banks.