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Dear Mr. Byres,

DB's response to the Basel Committee on Banking Supervision consultation on revisions to the securitisation framework

We appreciate the opportunity to provide feedback on the Committee's proposed revisions to the securitisations framework.

We welcome the proposed changes made by the Basel Committee to simplify the securitisation framework. We remain concerned that the Committee's application of this principle is very punitive and the resulting capital charges for securitisation would be a multiple of charges for the underlying portfolio pre-securitisation.

Left unchanged, the proposed rules would substantially reduce the incentives for banks to participate in securitisations and may have a considerable impact on the securitisation market and the availability of affordable credit to the wider economy.

In our view, the best way to calibrate the capital requirements would be to start from the point where the capital charge for the underlying pool and the capital charge for the securitisation are identical. As a second step, the calibration of the different tranches may include a suitable prudential buffer to address model risk and securitisation specific structural features. If the prudence add-on is too high, the proposed rules would have significant costs, not just for the viability of the securitisation business but also to the broader economy as the securitisation as a financing technique will be further discouraged. That would run counter to calls from the Financial Stability Board, International Organization of Securities Commissions and the European Central Bank to revive the securitisation market.

Our general comments and responses to the specific questions are in the Annex. We hope you will find these comments helpful. Please let us know if we can provide further information.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'AP', written over a light blue horizontal line.

Andrew Procter
Global Head of Government and
Regulatory Affairs



ANNEX – comments on the proposed framework

1. General comments

1.1 Hierarchy of approaches

Treatment of resecuritisations

The Committee proposes to only allow the Standardised Approach (SA) for resecuritisations. According to the definition (paragraph 5), a resecuritisation is a securitisation in which the risk associated with an underlying pool of exposures is tranching and at least one of the underlying exposures is a securitisation. We understand the Committee's view that resecuritisations are inherently difficult to model. Under the SA, it is proposed that the capital requirement of the underlying securitisation exposure is calculated using the securitisation framework.

Taking the Committee's view into account, we would propose to allow the Internal Ratings-Based Approach (IRBA) for resecuritisations of mixed pools of securitisation and non-securitisation positions, calculating the capital requirement of the underlying non-securitisation exposures by using the IRBA while assigning a 1250% risk weight to the underlying securitisation exposures.

This would allow more sophisticated banks to appropriately account for the risks and fit with the Committee's overarching objective of balancing risk sensitivity, simplicity and comparability. Additionally, using IRBA, would help meet the objective of reducing the mechanistic reliance on external ratings as the capital charge for the underlying pool would be calculated mainly based on an approved and suitable IRB model. Under the SA, the capital charge for the underlying exposures is instead calculated mainly based on external ratings.

If this proposal is not incorporated into the final rules text, we would suggest that a certain threshold could be set, i.e. the IRBA can be used as long as a certain percentage of the underlying exposures are non-securitisations.

According to the proposed rules, the caps seem to be only applicable for securitisations. We propose to extend these caps also to re-securitisations with the following adjustment possibilities for securitisations in the underlying pools:

- where the bank can look through to the underlying exposures of the securitisation in the pool, the applicable IRB or CRSA risk weights are used;
- a risk weight based on the securitisation framework is used for the securitisation in the pool; or
- as a fall-back, a risk weight of 1250% is used.

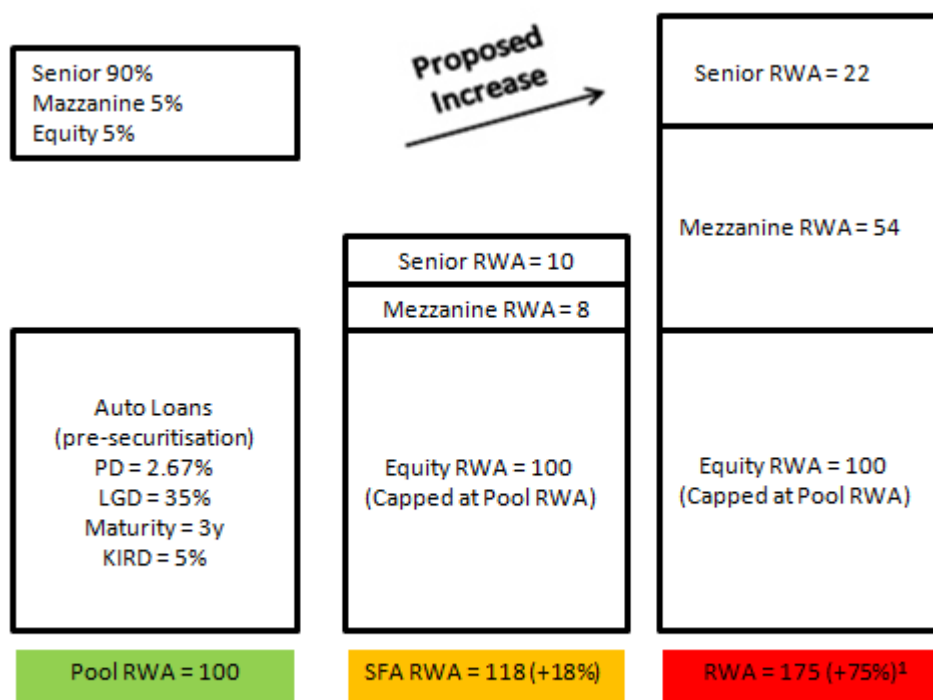
If the standardised approach is applied for re-securitisations, we propose a pro-rata calculation of the supervisory parameter 'p' to adequately reflect the risk.

1.2. Proposed approaches

Our concern with the proposal is that the resulting capital charges for securitisations are substantially higher than for the underlying portfolio pre-securitisation. As shown in the example below the securitisation risk weighted assets (RWA) based on IRBA leads to implausible results when compared to the (pre-securitisation) RWA of the pool. In certain cases, the capital charges for senior notes are so punitive that the benefit of credit enhancement would no longer be recognised.



Chart 1. An example of calculation of RWA for Auto Loan¹



Internal Ratings-Based Approach (IRBA)

In the descriptive section, it is said that the flexibility in calculating K_{IRB} by using the top-down approach under the current framework to estimate internal PD and/or LGDs for purchased receivables (paragraphs 362 to 372 of the current Basel framework) will remain under the proposed revised securitisation framework. This flexibility should be explicitly mentioned in the proposed rules text.

Definition of K_{IRB}

According to paragraph 50, K_{IRB} is the ratio of (a) the capital requirements (including the expected loss) for the underlying exposures in the pool to (b) the exposure amount of the pool (e.g. the sum of drawn amounts related to the securitised exposures plus the exposure at default associated with undrawn commitments related to securitised exposures). This means that for off-balance sheet exposures (e.g. undrawn commitments) the notional is multiplied by the applicable credit conversion factor. The definition of both the attachment point and the detachment point (see paragraph 52 and 53) refers to the nominal amount of the underlying exposures, i.e. without the applicable credit conversion factor.

In our view, this leads to the fact that the risk is significantly overestimated for the tranches based on the proposed definition of K_{IRB} .

One example is where the capital requirements for the underlying pool is EUR 50 million and the sum of the notional amounts of the tranches equals EUR 1 billion whereas the exposure at default for the underlying pool is EUR 600 million. In this scenario, the K_{IRB} based on the exposure at default is 8.33%, whereas K_{IRB} is 5% based on the notional amount.

¹ IRBA compatibility means that the bank is capable of calculating the IRB parameters for the underlying exposures.



Under the IRBA, a tranche with a notional amount of EUR 83.33 million as First Loss Piece would receive a risk weight of 1250% based on the proposed definition. In our view, this does not adequately reflect the risk of the underlying pool as the overall capital requirement of the pool equals EUR 50 million and not EUR 83.33 million. Therefore we propose to change the definition and use the nominal amount of the underlying pool as a denominator for the K_{IRB} definition.

Risk-weight for senior tranches with credit enhancement ($K_{IRB} > \text{attachment point}$)

When K_{IRB} is less than, but close to the attachment point of a tranche, the risk weight under the new framework is significantly higher in comparison to the current framework. In our view this is not adequate due to the fact that the K_{IRB} covers portfolio losses for 99.9% of cases. This is the case for both high risk and low risk pools since riskiness of the assets is already reflected in K_{IRB} .

K_{IRB} (by construction) is an internationally agreed metric to derive capital requirements for the underlying pool. There is, therefore, a very good reason for low capital charges of senior tranches with credit enhancement.

The components to calculate K_{IRB} are asset class specific and are validated by historical loss data, leading to higher capital charges for asset classes with historically high credit losses. Therefore, for senior tranches where the credit enhancement exceeds the K_{IRB} , the tranche is very unlikely to suffer losses, endorsing that the risk weight is already sufficiently conservative.

Recognition of Excess Spread

While the consultative paper states that excess spread is recognised in the calibration of the IRBA, this is not obvious from the very high relative risk weights calculated for senior tranches with non-prime retail underlyings (e.g. sub-prime auto loans). Given the high coupon rate of the underlying assets, excess spread is a major part of credit enhancement in these transactions which does not appear to be fully recognised in the calibration.

Internal Assessment Approach

The Internal Assessment Approach (IAA) should be used in the case of unrated exposures to Asset-backed commercial paper (ABCP) programmes (e.g. liquidity facilities and credit enhancements) regardless of whether the underlying pool is an IRBA, a mixed or an SA pool. On page 9, it is required that a bank must have supervisory approval to use an IRBA for a predominant share of the type of underlying pool exposures. However, the proposed rules text (paragraph 46) allows the IAA application only for securitisation exposure to an ABCP programme that is an SA pool, but also requires that the bank has supervisory approval to use the IRBA. It should be clarified that the IAA can be used for IRBA, SA and mixed pools.

Standardised Approach

According to the proposed rules text, the supervisory parameter 'p' is set equal to 1 for a securitisation and to 1.5 for resecuritisation whereas the equivalent US Simplified Supervisory Formula Approach (SSFA) uses a supervisory parameter of 0.5. We suggest that consistency with the current US formulation be preserved.

Treatment of mixed pools

In principle, we welcome the new proposal for mixed pools giving more flexibility to use the different approaches. The proposed rules text (paragraph 48) allows the bank to choose between two different alternatives. We understand that this choice can be made by the bank for each securitisation exposure differently. A consistent choice for all securitisation transactions with



mixed pools would not make sense as the securitised pool and the corresponding percentage of the IRBA compatibility² can differ significantly between the various securitisation transactions.

Under the proposed Alternative I for mixed pools, the IRBA is used, but a 1250% risk weight is assigned to those exposures for which the IRB parameters cannot be calculated. Rather than using a 1250% risk weight for those exposures as a fallback solution, we propose to determine the risk weight for non-IRB underlying exposures based on the rules under the Credit Risk Standardised Approach (CRSA) as this would be a more appropriate than a flat risk weight of 1250%.

If the Committee is concerned that too many exposures in the underlying pool are assigned a CRSA risk weight, we propose to introduce a threshold such that CRSA exposures below the threshold receive a CRSA risk weight and CRSA exposures above the threshold receive a risk weight of 150% which is equal to the CRSA risk weight for defaulted exposures.

1.3. Other proposed revisions and clarifications

Definition of tranche maturity

Maturity is already accounted for in most methodologies applied by the rating agencies and in the K_{IRB} calculation. Including it in RWA settings at tranche level will lead to double counting.

Should the Committee nevertheless decide to include maturity in the calculations, the proposed framework of maturity mismatch, as well as the current framework, which compares the longest maturity of an asset in the pool to the securitisation maturity, is too conservative, because it penalises an entire securitisation for the maturity of one (or very few) assets in the pool. We propose to calculate the maturity of the tranche based on the weighted average maturity of the assets in the pool as we believe this more accurately represents the risk in the securitised pool.

The BCBS proposes to calculate tranche maturity as the remaining effective maturity in years measured as the weighted-average maturity of the contractual cash flows of the tranche (assuming no prepayments or defaults), subject to a five-year cap and a one-year floor. If such unconditional contractual payment dates are not available, a bank instead has to use the final legal maturity subject to the same cap and floor.

Generally, a securitisation tranche does not have contractually fixed payments on fixed payment dates; therefore the bank would be subject to the final legal maturity. One typical factor influencing the economic maturity of securitisation positions is early repayment (prepayments). Using parameters derived from historical data as assumptions for calculating the maturity should be allowed. Due to the fact that some transactions also envisage so-called performance triggers which are tied to default or late payment ratios and which may trigger changes to the interest waterfall and / or repayment waterfall, the respective necessary exemptions should also be allowed when calculating the residual term to maturity. A failure to recognise such economic realities would be inconsistent with the characteristics of securitisations.

According to paragraph 23, banks should take into account the maximum period of time they are exposed to potential losses from the securitised assets. In cases where a bank provides a commitment, the bank should calculate the maturity of the securitisation exposure resulting from this commitment as the sum of the contractual maturity of the commitment and the longest maturity of the assets to which the bank would be exposed after a draw has occurred. The Committee proposes that the same treatment applies to all other instruments where the risk of the commitment/protection provider is not limited to losses realised until the maturity of that



instrument. The Total Return Swap is mentioned as one example. We do not support this example as the risk of a Total Return Swap is generally limited to losses realised until the maturity of that Total Return Swap.

Risk-weight floor of 15%

As indicated below, the Risk Weight floor of 15% would be much higher than the risk weight that could be derived for corporate assets with similar risk characteristics. The introduction of a high risk weight floor reduces the risk sensitivity of the framework and similar to the overly conservative calibration will provide incentives for banks to take on more risk.

In the table below, we outline the risk weights that result from three different approaches (Corporate IRB framework, SFA and IRBA). The mezzanine note in the Auto Loan Securitisation example (see below)) has a default probability of 0.10%. Under the IRBA, the Risk Weight for such a position is 672%]. This is more than 8 times higher than the risk weight for a corporate position with the same PD and a worst case LGD assumption of 100%. As shown in the table below, the SFA already provides a conservatism add-on compared to the non-securitisation risk weights.

Table 1.

Tranche	PD	LGD	Risk Weight based on corporate IRB framework (incl. EL component)	SFA	IRBA
Senior*	0.03%	10%	4%	7%	15%
Mezzanine**	0.10%	100%	80%	101%	672%

*PD and LGD based on Vasicek formula but floored at 0.03% and 10% respectively

** PD based on definition of KIRB. LGD assumed worst case for illustration.

Tranche Risk Weight based on Corporate IRB framework (incl. EL component) PD* LGD** SFA, IRBA

Maximum capital charge (overall cap)

The Committee's proposal to retain the provision – that the capital charge is limited to the amount of capital the bank would hold if it held the underlying assets directly – is highly appreciated. On page 18, it is said that the Committee initially proposed to apply an overall cap to capital requirements not only to IRB banks, but also to all originators and sponsors, even if they cannot calculate IRB inputs for the underlying pool.

On page 18, the Committee also says that it proposes that the overall cap be applicable regardless of the approach that is applied. However, according to the proposed rules text (paragraph 81), under the External Ratings-Based Approach or Standardised Approach, only the originator or sponsor can apply the overall cap. We do not see the reason why this cap is limited to originator and sponsor under these two approaches as long as the investor has sufficient information about the underlying assets. Therefore we propose that this overall cap should also apply to investors that have sufficient information about the underlying assets and are therefore capable of calculating the capital charge of the underlying pool.

According to paragraph 38 and 51, specific provisions on underlying assets and non-refundable purchase price discounts on such underlyings can offset 1250% risk weighted securitisation exposures under the IRBA. We cannot understand why this option is only available for 1250% risk weighted securitisation exposures and we therefore propose that these specific provisions and non-refundable purchase price discounts for the underlying assets can be included when calculating the overall cap.



Treatment of write-downs and purchase price discounts on tranche level

The Committee proposes to use the carrying accounting value as exposure value whereas the European Capital Requirements Regulation (CRR) requires the sum of the carrying accounting value plus credit risk adjustments. However, under the CRR, these credit risk adjustments can be used to reduce the RWA for these securitisations.

The Committee does not support this offset as i) the differentiation between credit related and non-credit related adjustment is complex and ii) this method would grant excessive capital benefit to write-downs and purchase price discounts. We disagree with this view and provide two different reasons for that:

1. This capital offset does make sense as these write-downs have already reduced the regulatory capital of the bank.
2. Under the wholesale IRB framework, a similar concept is used. The expected loss must be deducted from capital, but this amount can be reduced by the write-downs.

Due diligence requirements

According to the proposed rules text (paragraph 35), a bank must assign a 1250% risk weight to any securitisation exposure for which it cannot perform the level of due diligence specified in paragraphs 32 to 34. Generally, this information is also required under the European Capital Requirements Regulation, however, in case of a breach, an additional risk weight of at least 250% (capped at 1250%) is imposed by the competent authority. We propose that the additional risk weight is determined based on the materiality of the breach and its relevance in both quantitative and qualitative terms at both entity and consolidated level. In assessing materiality, various factors should be considered, e.g. the duration of the breach, the size of the affected positions and whether the institution has attempted to proactively rectify the breach.

Grandfathering of existing transactions

According to the text, the Committee intends to publish the final standard within an appropriate timeframe, and provide sufficient time for implementation without the need for grandfathering provisions. The new regulations will come only after an appropriate transition period for the application. According to the call with the Committee on 11 February, it was indicated that the final rules will apply from 2016 or 2017 onwards.

We are, however, concerned if no grandfathering for already existing transactions is provided as the pricing of these securitisations were carried out in the expectation that the existing rules will remain for the total duration of the transaction. An increase in the capital requirements for existing securitisation positions would lead to the fact that many transactions would have been uneconomical.

Treatment of market value hedging transactions

According to the proposed text, the market value hedging transactions such as currency or interest rate swaps will be inferred from the next subordinated tranche. In addition, paragraph 64 lays down the requirements for inferring a rating for an unrated securitisation position.

For market value hedging transactions, we believe that it is sufficient if the reference position ranks pari passu to the unrated swap. This leads to a more risk adequate treatment of unrated market value hedging transactions for the purpose of inferring ratings and acknowledges the particular seniority of these transactions reflected in other parts of the text (e.g. paragraph 18).



1.4. Economic impact

While the current proposal is an improvement over the original proposed rules, it is important to look at the impact the increased capital charges will have on the issuance of securitisation.

Re-establishing securitisation is seen as a priority in order to support provisions of credit to the real economy and improve banks' access to funding in many jurisdictions. The Financial Stability Board, European Central Bank, International Organization of Securities Commissions and the European Central Bank are just a few examples of international bodies which have called for a revival of securitisation. However, securitisation issuance is severely depressed in Europe.

In order not to heavily discourage securitisation issuance and allow for a return of a healthy securitisation market and continued growth in global markets, the capital requirements for securitisations need to be calibrated in a balanced way as outlined in our detailed response.

Please see our response to the first consultation paper for further detail.

2. Question-related comments

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 agree with the Committee's proposal to exclude the currency swaps and interest rate swaps of the special purpose entity (SPE) when calculating the attachment and detachment point. However, as indicated above we believe it appropriate to infer ratings from a pari-passu securitisation tranche. Generally, these exposures represent the super senior tranches and will be subject to the risk weight floor which ensures a conservative treatment. Therefore it is adequate that an add-on for the potential future exposure is not required.

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".*

Under the IRBA, the parameter "p" represents the relative capital surcharge for all securitisation tranches compared to the capital requirement for the underlying pool. According to the proposed maximum formula, the parameter is subject to a floor of 0.3 meaning that the capital requirements for all securitisation exposures is at least 30% higher than the capital requirement for the underlying exposures if held directly by the bank. In our view, 30% for reflecting model risks and structural features inherent in securitisations is too high (see further explanation on pages 3-4).

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 strongly support the introduction of a 'pro rata cap' as this will lead to a more risk-sensitive approach. More importantly, as mentioned above we believe it essential that the Committee revisit the risk weight calibration to be more consistent with the underlying risks of the portfolio, in which case the recourse to such a crude method to correct for overly conservative risk weights is only necessary in limited cases.