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Basel Committee on Banking Supervision
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Subject: NVB reaction to BCBS269 Revisions to the securitisation framework

Dear Sir, Madam,

On behalf of the Dutch Banking Association[1] (NVB) I would like to thank you for giving us the opportunity to react to BCBS 269 regarding proposed revisions to the securitisation framework. As this consultation is a follow up on BCBS 236 'Revisions to the Basel Securitisation Framework', we also refer to the response we provided to that paper.

Approach has been simplified
Compared to the previous version of the revised framework for securitisations, the Basel Committee has made significant progress in simplifying the framework and better aligning risk weights to actual loss experience. Especially positive in this regard is the introduction of the internal ratings based approach, which is simpler than the previously proposed MSFA. Although the complexity of the most advanced approach has been reduced, the concerns about the resulting risk weights remain.

Risk weights are still conservative compared to credit performance
Compared to the MSFA, the IRB approach produces more realistic, but steep risk weights for senior tranches of Dutch RMBS and other securitised low default (retail-) assets. This will increase the cost of financing real economy loans. The risk weights applied to all securitisation tranches, but especially those applied to longer-dated securitisations, still significantly overstate the expected and unexpected loss levels associated with the underlying exposures. They also underestimate the benefit of credit enhancement for both senior and mezzanine tranches. Recently published performance data[2] underscores the low loss levels, especially for transactions in major European asset-backed securities markets. Next to this, rating agencies have increased the stress levels applied to losses in their ABS rating methodologies, which has significantly increased the credit enhancement levels.

[1] The Dutch Banking Association (NVB) is the representative voice of the Dutch banking community with over 90 member firms, large and small, domestic and international, carrying out business in the Dutch market and overseas. The NVB strives towards a strong, healthy and internationally competitive banking industry in the Netherlands, whilst working towards wider single market aims in Europe.
[2] Such as Moody's: "UK Prime RMBS indices" (2 December 2013), Moody's: "Dutch Prime and NHG RMBS Indices December 2013" (28 February 2014), Fitch: "Mortgage Market Index – Netherlands" (19 February 2014).

High quality securitisation should receive a lower capital charge than currently proposed

Over the last years, the industry has developed a number of initiatives that enable investors to better identify quality transactions by means of increased transparency and reduced complexity. In Europe, the quality label "Prime Collateralised Securities" (PCS) has been launched. In the Netherlands, a standard has been developed for Dutch RMBS by the Dutch Securitisation Association[3] and in Germany TSI has developed a similar standard for car loan securitisations. On top of this, RMBS loan level data has to be provided to the European data warehouse, before the instrument can become eligible for ECB collateral swaps. The increased transparency and the high quality of the underling assets warrants a more favourable treatment compared to the proposed risk weighting.

The concept of high quality securitisations has repeatedly been mentioned as a way to preserve securitisation as an indispensable tool for funding the real economy, while avoiding the pitfalls of sub-prime mortgage securitisations in the past. The concept was also referred to in the regulation of insurance companies; high quality securitisations have recently been incorporated in the EIOPA Technical Report on Standard Formula Design and calibration for Certain Long-Term Investments; the implementation document for Solvency II.

The calibration of senior tranches of retail based securitisations is still punitive

According to our analysis, the look through approach, will still have to be applied to a majority of senior tranches of retail based securitisations. The economic drivers that dictate asset performance vary greatly across asset classes and jurisdictions. A car loan cannot be compared to a mortgage loan, and the performance of loans in the same asset class is often closely linked to the state of the economy. The framework proposed by the Basel Committee still does not distinguish between any of the asset classes used for securitisation, nor does it take into account the different risk characteristics, or economic circumstances. Especially mortgages have different risk characteristics in comparison to other assets. The causes behind these differences lie in variations in the legal frameworks (e.g. borrower recourse), differences in social security and economic circumstances. Not distinguishing between asset classes penalises assets with below average risk weights, which are primarily retail loans. Also, securitisation does not change the total amount of risk associated with the asset pool; the total risk weight prior to and post securitisation should be comparable.

The look through approach does not alleviate the high risk weights

In order to mitigate the aforementioned fundamental points, the Basel Committee built in a feature that ensures the risk weight of a senior tranche does not exceed the risk weight of the underlying asset pool; the risk weight cap. Unfortunately, banks acting as an investor will not be able to use the IRBA method, as they do not have the data required to establish the required modelling capability for portfolios they do not originate themselves. The reaction provided by the NVB to bcbs 236 contains a solution to this problem, which would allow investing banks to utilise the risk characteristics calculated by the originating bank. Please refer to the section called "The application of the risk weight cap" in NVB response to BCBS 236 - Revisions to the Basel Securitisation Framework, ref BR1840 for more information.

Maturity

The definition of maturity is very conservative and should be revisited. In practice, the vast majority of securitisations do not have contractually fixed payments. Consequently, the legal maturity overstates the economic maturity, which leads to a significant overestimation of risk weights for many transactions. Next to this, the tranche maturity definition (paragraph 23) is open to different interpretations:

- The wording of the definition seems to suggest that maturity should be defined as the period of time that the bank is exposed to losses. Given the conditions (strong triggers and covenants)

[3] Please see http://www.dutchsecuritisation.nl/dutch-securitisation-standard for more information

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which will stop commitment, the maximum exposing period will be the maximum payment term of the assets. For trade receivables this is usually lower than 180 days. Hence, the 1 year floor will apply in this case.

- But the rest of the definition seems to suggest that for revolving assets, the sum of the commitment period and the longest maturity of the assets which might be added to the structure would determine the tranche maturity. This will have a significant impact on existing transactions given that the floor will increase from 15% to 25% for a 5 year deal.

In our view, committed exposures with strong covenants and triggers should be treated the same as uncommitted exposures. This is substantiated with two examples of committed transactions where the proposed regulation is too conservative.

Trade receivables
Trade receivables transactions can have long commitment period of for example 3-5 years, where the program commits to buy receivables on a revolving basis, as long as certain conditions are satisfied. Not meeting these conditions (triggers on delinquency ratio, default ratio, dilution ratio, average Days Sales Outstanding (DSO), weighted average maturity, write offs etc) will cancel the commitment. This prevents any losses on the portfolio in excess of the losses on the receivables already purchased. So, despite the longer commitment, the bank is only exposed for the maximum payment terms in the portfolio.

Lease receivables
In most cases, strong covenants and triggers are included in portfolios. In the case of auto leases securitisations, conditions related to the defaulted leases, the weighted average remaining tenor, the residual value, etc. are set that will cancel the commitment. As with the first example, taking into account the commitment term plus the longest maturity of the assets is overly conservative.

<u>The treatment of call options under the operational requirements for the recognition of risk transfer</u>
It is clear that regulators are becoming more critical to the use of call options in cases where recognition of risk transfer is sought. Under section C. (Operational requirements for the recognition of risk transference) in article 24 (g) the wording was changed, which will affect transactions that neither contain provisions for (re-)purchase of underlying assets nor suggest an intention to repurchase by the originators, but that do contain rights to call that do not impact the originator, such as in case of cash flow CLOs. In cash flow CLOs, the issuer has a right to call its issued notes provided it can sell assets into the market with sufficient proceeds to redeem the outstanding rated notes. For securitisation structures that support beneficial lending such as (infrastructure-) project financing, an outright ban on the use of call options that results from the changed wording, would make the funding of the securitised real economy loans more expensive. There should be room to continue the current approach, where competent authorities decide on a case by case basis if significant risk transfer had been achieved by the originator or not.

This concludes our main remarks. In the annex, you will find more detailed feedback and our answers to the questions.

Kind regards,

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Annex – Observations and answers to the consultation questions

Observations
The wording in paragraph 46 is not entirely clear. We propose to apply the following changes:

"*46. A bank that is located in a jurisdiction that permits use of the External Ratings-Based Approach may use an Internal Assessment Approach (IAA) as described in paragraphs 66 to 69 for its unrated securitisation exposure (e.g. liquidity facilities and credit enhancements) to an ABCP programme that ~~is an~~* ***contains*** *SA pool**s**. In order to use the IAA, a bank must have supervisory approval to use the IRB approach. A bank should consult with its national supervisor on whether and when it can apply the IAA to its securitisation exposures, especially where the bank can apply IRB for some, but not all underlying exposures. To ensure appropriate capital levels, there may be instances where the supervisor requires a treatment other than this general rule.*"

In paragraph 87, it is not clear how the treatment of CRM that is used for hedging mezzanine tranches will work, as the text appears not to allow such hedges: "*87. When applying credit risk mitigation techniques, the bank may reduce the capital charge proportionally when the credit risk mitigant covers first losses or losses on a proportional basis. For all other cases, the bank must assume that the credit risk mitigant covers the most senior portion of the securitisation exposure (i.e. that the most junior portion of the securitisation exposure is uncovered).*"

Answers to the 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.

Answer:
This question is not clear to us. If it pertains to inferred ratings, the answer is yes, but if it relates to the treatment of swaps, the answer is no. In our view, from the perspective of investors in the securitisation, the risk on the derivatives used in securitisations is negligible. There are rating triggers on the swap provider and the swap counterparty has to provide cash collateral. Furthermore, this treatment would require an investor in a securitisation to value a non-standard swap. It is not clear why a positive value should result in an additional IRB capital charges, as the SPE would receive a higher swap interest income compared to the interest on the underlying assets. If the intent is to require additional capital for swaps in a securitisation, it is not clear why the Basel Committee does not take the mitigating factors, such as hedges and seniority in the SPE waterfall, into account.

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".

Answer:
The determination of the supervisory adjustment factor "p" which is part of the SSFA is very complex. We understand that these factors were found to produce better statistical results. Nevertheless, a less complex approach would be preferable. Also, the outcome of 'p' changes, as Mt (the maturity of a tranche) changes. Given the way Mt is set up, there will be no differences in the maturities of tranches of RMBSs; they will typically be capped at five years. Next to this, all non-senior tranches are expected to have a similar p value and the calculation of the tranche maturity should incorporate constant prepayment rates. However, the Basel Committee states the expected

cash flows that are to be used in the Mt calculation should not take prepayments into account. This will result in overstated maturities, as prepayments are not zero, but lie in the range of about 3 to 6%.

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.

Answer: The NVB supports the pro rata calculation, as it makes perfect sense for both originator and investor banks. The pro rata cap is calculated based on the risk weights calculated under a conservative regime, which would actually warrant an override using a more reasonable cap. From an originator's perspective, a more than pro rata allocation of the cap would imply that a bank that retains or repurchases some of its own securitisations would end up with a capital charge significantly higher than the capital charge before securitisation, which is counterintuitive. For an investing bank, we refer to the statements made earlier about the issues that impede the application of the IRB approach. Anything more penalising than a pro rata cap, would again require investors to hold more capital against their investments than is justified based on the quality of the underlying pool.