



Brussels, 21 March 2014

Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of almost 4,500 banks: large and small, wholesale and retail, local and cross-border financial institutions. Together these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the European Union.

Subject : EBF response to the BCBS second consultation on revisions to the Basel Securitisation Framework

The EBF welcomes this new opportunity to express the views of the EU banking industry in the light of the second consultative paper of the Basel Committee for the Revised Securitisation Framework.

The EBF response¹ is organised in three sections: Firstly, an executive summary with the main observations of the EBF to this second consultative paper; secondly, the EBF considerations and proposals regarding a series of relevant issues affecting the impact of the revised framework on the European securitisation market (an index is provided at the beginning of the section in page 3); finally, the EBF responses to the three questions of the BCBS consultative paper.

Executive summary

The EBF welcomes the shift towards simplification of the hierarchy seen in this second version of the revised framework for securitisation. The introduction of the internal ratings based approach which is simpler than the previously proposed MSFA is a move in the right direction. Nevertheless, additional work needs to be done to strengthen the risk sensitivity of the framework and to smooth the steepness of the risk weights. The EBF considers that the rules could benefit from further consistency of treatment across the hierarchy of approaches.

It is also worth noting that relevant measures have already been taken since the wake of the crisis making the securitisation market significantly safer from a prudential point of view. In particular, a series of policy measures to address the shortcomings that became apparent in the pre-crisis

¹ EBF contact person: Gonzalo Gasós, Senior Policy Adviser (g.gasos@ebf-fbe.eu).

securitisation framework have already been put into force in the EU. The EBF suggests that the Committee takes full account of all regulatory changes in the assessment of the revised securitisation framework.

We would like to draw the attention of the Committee to the fact that the EU is making every effort to maintain a securitisation market that is instrumental in the funding of the European economy. In this vein, the EBF would like that the Committee carefully considered the following aspects:

- For responding to the aim of increasing the risk sensitivity of the regulatory framework, the calibration of the proposed approaches needs to be reviewed. The EBF supports the Conservative Monotone Approach (CMA) as a more conservative and simpler development of the Arbitrage Free Approach (AFA) proposed by the banking industry in 2013. In contrast with the revised MSFA (which is a formulae) the CMA is a transparent risk model. The SSFA (for both IRBA and SA approaches) could then be calibrated by the CMA.
- The ERBA should also be aligned to the newly recalibrated IRBA and SA, with a view of increasing the consistency of treatment across the hierarchy of approaches.
- High-quality securitisation assets need to be correctly addressed by the regulatory framework (i.e. according to their risk profile thus avoiding unduly conservative treatment). For this purpose, high quality labels could be recognised in the assessment of the capital requirement of qualifying securitisations which should be commensurate to the lower risk involved or in setting up a prudential definition for the high quality securitisation. A separate calibration should be considered for plain vanilla high quality securitisations linked to real economy financing, with lower floors.
- The BCBS should define a set of minimum requirements for the K_{irb} calculation that would allow sufficient flexibility in the calculation implementation, depending on the available information. Specifically a simplified top-down-calculation of K_{irb} based on historical loss rates provided by the originator should be explicitly made possible.
- The use of the internal rating based approach is mostly welcome in the case of mixed pools, however the extremely high risk weight assigned to residual exposures in the underlying pool could mar the objective to revitalise the use of this vehicle that is central to financing the economy. It should be revisited.
- In the case of the external rating based approach, the BCBS should consider the potential duplication of risk factors like the tranche maturity which are included in the assessment of the ECAs.

- In the IAA provisions the requirement that a bank must have IRB approval for the predominant share of the underlying assets should be removed.
- If counterparties fulfil certain eligibility criteria, there should be no additional capital add-on for the counterparty risk of embedded swaps or cash deposits. Furthermore, the definition of maturity should be revisited as it remains, in the view of the EBF, overly conservative. In practice, the vast majority of securitisations do not have contractually fixed payments, therefore the legal maturity which is vaguely connected to the actual maturity would have to be used leading to a significant overestimation of risk weights for many transactions.

EBF considerations and proposals

The EBF considerations cover the following topics:

1. The multiplicity of policy measures (page 4);
2. The credit loss experience of EU-originated securitisations (page 6);
3. Recalibration of the approaches: Increasing the risk sensitiveness of the framework while enhancing its simplicity and transparency (page 7);
4. The proposed hierarchies (page 14);
5. Usefulness of high-quality labels (page 15);
6. Risk weights and floors (page 16);
7. Risk weights of mixed pools (page 17);
8. External Ratings Based Approach and mapping of credit quality steps (page 19);
9. Maturity adjustments (page 20);
10. Due diligence requirements (page 22);
11. Attachment and detachment points (page 22);
12. Application of the IAA (page 24);
13. Treatment of counterparty risk in the calculation of K_{irb} (page 24);

EBF responses to BCBS specific questions

14. Response to BCBS question 1 (page 25);
15. Response to BCBS question 2 (page 26);
16. Response to BCBS question 3 (page 28).

1. On the multiplicity of policy measures

The EBF would urge the Committee to carefully take into account that the revised securitisation framework comes last in a series of policy measures that do (and will continue to) tighten significantly the regulatory environment of securitisations. It is imperative to consider the overall impact of all these measures in the assessment of the revised securitisation framework.

As a matter of background, several new regulations enacted in the EU (see synopsis of current EU regulations in box 1) have tightened up the prudential treatment of securitisations by means of:

- Alignment of incentives between originators and investors or *skin in the game*;
- Reduction of mechanistic reliance on external ratings;
- Measures to increase transparency;
- Adequate control of credit rating agencies;
- Increased capital requirements;
- Review of *correlation trading books*;
- Heightened requirements for complex structures.

Box 1: Regulations already enforced in the EU related to securitisations

(i) Initiatives to promote a better alignment of incentives: Retention requirement.

- Securitisation sponsors or originators are required to retain a part of the risk of the underlying assets to correct possible misalignments between the interests of securitising institutions and those of investors and to encourage originators to apply rigorous lending policies.
- Introduced in the EU banking legislation, which entered into force on 31 December 2010 (CRD II² Article 122a) and also in other regulations affecting other potential investors in bank-originated securitised products such as investment funds and insurance companies.

(ii) Measures to increase transparency

- CRD III³ has amended EU banking legislation to include a wide range of new disclosure requirements which the Basel Committee had recommended, particularly concerning asset-backed securities held in the trading book, the sponsorship terms for off-balance-sheet items and the methodology used for valuating products on the balance sheet.
- the European Central Bank, in order to ensure an adequate risk assessment of the asset-backed securities that the Eurosystem accepts as collateral, published in December 2009 its decision to require loan-by-loan information on the underlying assets backing securitisations, as a factor to be taken into account in the eligibility criteria.

² [EU Capital Requirements Directive II.](#)

³ [EU Capital Requirements Directive III.](#)

(iii) New regulations on credit rating agencies

- Credit Rating Agencies have now been made subject to specific regulatory supervision in the EU⁴, including registration, measures to reduce conflict-of-interest, requirement to use models that are rigorous, systematic, consistent and subject to validation based on historical experience.

(iv) Increased Capital Requirements in Basel 2.5

CRD III transposed into European legislation amendments made by the Basel Committee to the Basel 2 framework known as Basel 2.5. These amendments have been enforced in the EU by 31st December 2011:

- The adjustments to the Basel II framework announced by the Basel Committee in July 2009, which received several adjustments in June 2010, established that securitisation positions held in the trading book need to be subjected to similar charges as those applied to securitisation positions held in the banking book.
- Additionally, *correlation trading books* were exempted from the full treatment for securitisation positions, qualifying either for a revised standardised charge or a capital charge based on a comprehensive risk measure.
- Also, with the aim of discouraging the issuance of the most complex ABS structures, requirements for re-securitisation have been strengthened by including a new weighting scale created *ad hoc* for these products, specifying increases at times of over 100%. In addition, all the lines of liquidity support for asset-backed securities, irrespective of their maturity, have a credit conversion factor of 50% (formerly, the conversion factor for lines with a maturity of less than one year was only 20%).

Significant measures have already been taken to address the shortcomings identified in the crisis and including the specific impact on securitisation and re-securitisation of the European Credit Rating Agencies (CRA / CRA 2 & CRA 3). It should be noted that the current RBA/IAA setup was introduced in Europe on 31st December 2007 and we would argue that the risk associated with securitisation has been appropriately capitalised. The loss experience on ABS originated since this time has been very low and does not warrant the suggested increase in RWAs. Additionally, Basel III implementation (CRR in the EU) requires higher levels of capital (including capital buffers), and of higher quality, for the same RWAs.

Other policy measures that will affect the regulatory picture of securitised instruments are also in the making (see synopsis of policy measures underway in box 2), including:

- The Basel 3 leverage ratio.
- The Basel 3 liquidity coverage ratio.
- The Basel 3 net stable funding ratio.
- The fundamental review of the trading book.

⁴ [EU Credit Rating Agencies Regulation voted in European Parliament on 16 January 2013.](#)

Box 2: Upcoming policy measures affecting securitisation

(i) The Basel 3 leverage ratio

- Retained positions of securitisation exposures as well as other forms of credit enhancements provided to the vehicle by the originator (e.g. liquidity facilities) could be included in the calculation of the leverage ratio.
- For non-derecognised securitisations, the underlying securitised portfolios (as opposed to the securitisation exposures) could be included in the leverage ratio calculation. Credit risk mitigation, synthetic (or unfunded) securitisations, will not reduce the exposures of the underlying portfolios.

(ii) The Basel 3 liquidity coverage ratio

- The original proposal was that securitisation bonds, even those with the highest qualifications or with sovereign guarantee, would be considered as completely illiquid assets for the calculation of the liquidity coverage ratio. This implies that banks should retain a stock of high quality liquid assets equivalent to 100% of the amount of debt securities maturing within the 30-day time horizon of the standard and 100% of the amount of assets that could potentially return to banks' balance sheets due to embedded options in these financing arrangements.
- The revision of the Basel liquidity framework of January 2013 contemplates some degree of recognition as highly liquid assets of certain RMBS. Nevertheless, the range of bonds that comply with the stringent conditions will be very limited.

(iii) The Basel 3 net stable funding ratio

- This standard provides a measure of liquidity risk exposure that acknowledges the need to fund securities in trading inventories or securitisation pipelines in the face of illiquid markets. As specified in the original proposal, banks are required to hold 65% stable funding for all residential mortgage loans that are warehoused in order to be securitised. Moreover, banks have to hold 100% stable funding for all other structured products on their balance sheet, like securitisations, including the substantial amounts of MBS that European banks are holding in the context of central bank operations.

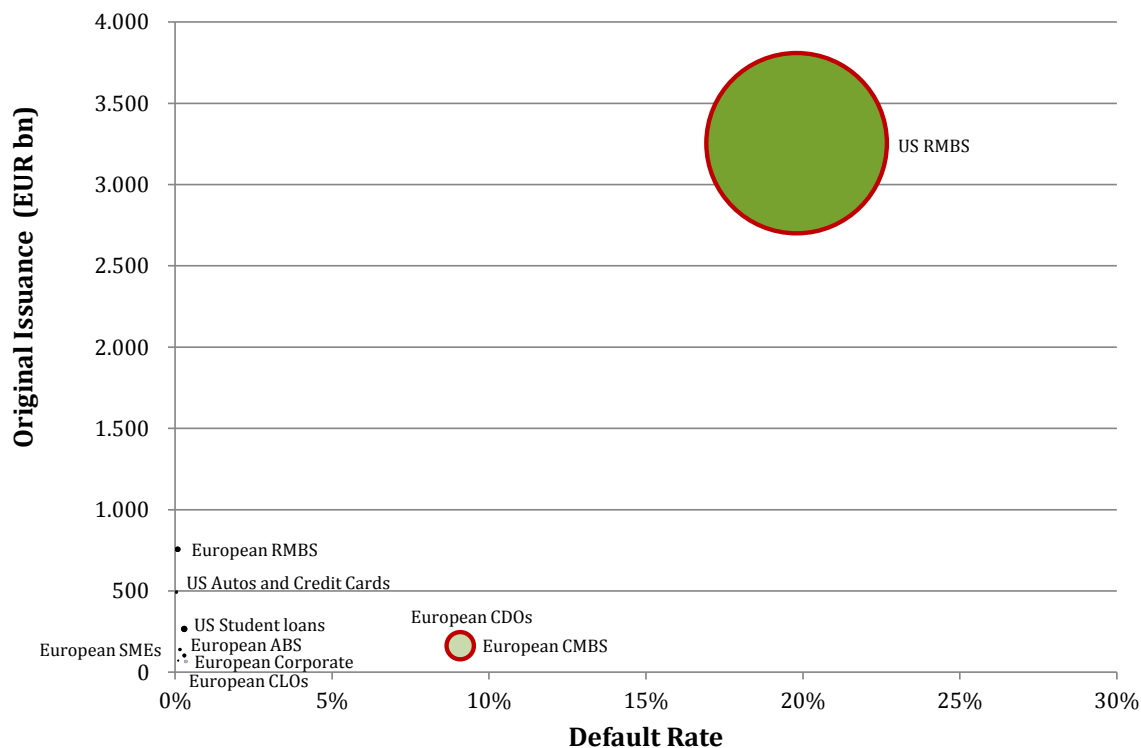
(iv) The Basel Fundamental Review of the Trading Book (FRTB)

- According to the FRTB a bank mitigating long risk securitisation positions with short risk securitisation positions will be requested to hold more capital than if it had only held the long risk position with no risk mitigation. It would ultimately pose a disincentive to banks to have well hedged books.

2. On the credit loss experience of EU-originated securitisations

The EBF is mindful of the need to overcome the failures experienced in the upsurge of the crisis. Nonetheless the EU securitisation market has its own characteristics. Its results should be observed from the viewpoint of origination as well as investment. The metrics used in the calibration should reflect the performance of the EU securitisation market which has withstood the crisis remarkably well producing negligible credit losses.

The following chart represents the historical default rates attributed to different type of securitisations by original issuance volumes and default rates:



(Sources: S&P and AFME)

The Quantitative Impact Assessment (QIS) that the Committee is known to be conducting at the moment, should aim at revealing the impact that the new proposals will have on different types of instruments according to their performance during and after the crisis that has given rise to this revision.

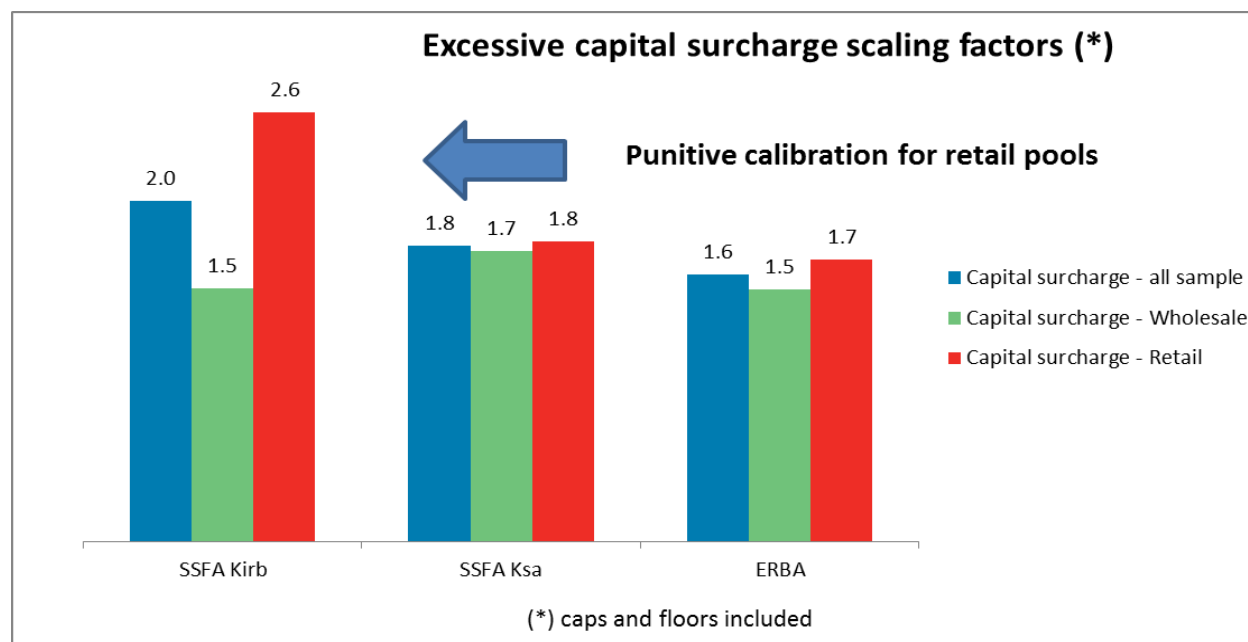
3. On the recalibration of the approaches: Increasing the risk sensitiveness of the framework while enhancing its simplicity and transparency

The EBF considers that the proposed increase in capital requirements is not justified and poses a threat on the revival of the securitisation as a useful funding tool:

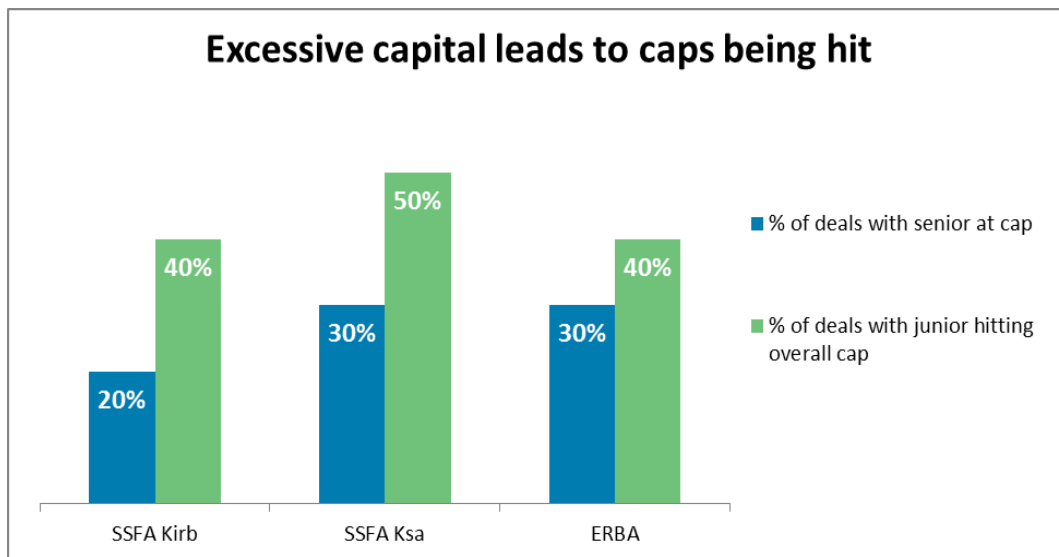
- The capital levels remain punitive, especially for retail assets:

We have used the same sample of 10 transactions as last year for the answer to BCBS 236 to test the impact of BCBS 269. The sample includes typical transactions across retail and corporate pools: French auto ABS, UK prime RMBS, 2 Benelux RMBS, US Subprime RMBS, French SME, Italian SME, CLO of high grade corporates, CLO of US leveraged pre crisis and CLO of US leveraged loans post crisis. We find that, taking caps and floors into account, the sum of capital requirements on the tranches is on average around two times the capital requirement on the pool.

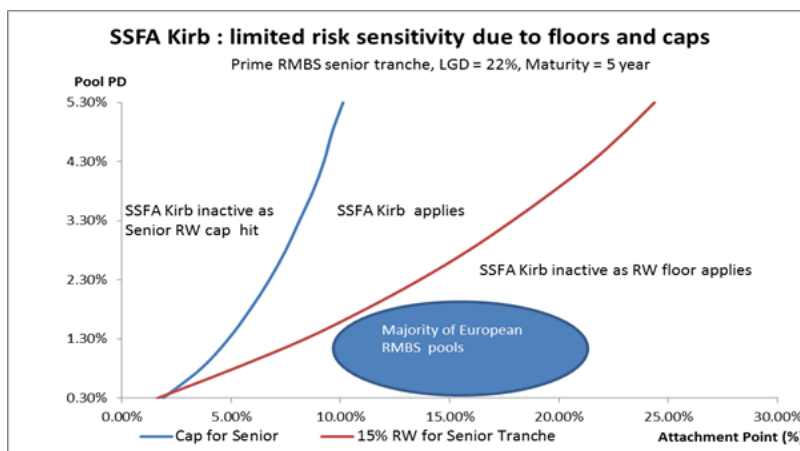
This level of capital surcharge scaling factors, which can be compared to $1+p$ (p in SSFA), remains elevated. It is particularly punitive for retail pools for which the capital surcharge scaling factor is 2.6 under the SSFA K_{irb} .



- Given the excessive conservative layer for model risk embedded into the calibration, in many cases the caps are hit. This is explained by the overly punitive capital surcharges used to calibrate the SSFA formula (both K_{irb} and SA) and for the calibration of the ERBA formula. For instance, under the SSFA SA formula, 30% of the deals in our sample hit the cap for the senior tranche RW and 50% of the junior tranches are hitting the overall cap.



- Due to its limited risk sensitivity, the proposed calibration will not apply to a large part of low risk securitisation transactions.
- For the vast majority of prime European RMBS, the senior tranche attaches in a range from around 8% to 25% and the range of IRBA approved PD is between 0.3% and 2%. We show in the following graph that for these ranges of senior attachment points and IRBA approved PD, the SSFA K_{irb} will not apply as the senior tranche will be at the 15% RW floor.



In a nutshell, the SSFA formula proposed by BCBS has three fundamental drawbacks which explain to a large extent the limited risk sensitivity and the arbitrage opportunities that its application would create:

- Oversimplification, due to reliance on a single unique p parameter, which is independent of asset type, maturity, and risk profiles in the SA-type SSFA and coarsely differentiated by Wholesale/Retail and Senior/Non-Senior tranches as well as linearly dependent on a number of deal features in the IRB-type SSFA. The SSFA is too simple to achieve a reasonable level of risk sensitivity for each asset class.
- Calibration based on a modified MSFA formula yielding unrealistic p values. In particular, the p value of 1.0 for the SSFA –SA is very high and not justified for corporate exposures (where p is around 0.3 for short term corporate exposures and 0.6 for long term corporate exposures), as well as not correctly calibrated for retail exposures (where p is between 0.3 and 1.4 depending on tranche maturity for the IRBA version of the SSFA).
- The 1250% risk weight below $K_{sa/irb}$ remains a structural feature of the securitization regulatory framework since Basel II, however this 1250% threshold implies substantial regulatory arbitrage.

The SSFA calibration is based on a modified MSFA formula as the SSFA is not a risk model⁵. For reaching the BCBS' stated objectives, the EBF supports the recalibration of SSFA-SA and SSFA –IRBA based on a simple, transparent risk model, named Conservative Monotone Approach (CMA)⁶.

The Conservative Monotone Approach is a development of the Arbitrage Free Approach (AFA) explained in a series of technical papers.⁷

The AFA is a rigorous, closed-form formula for securitization tranche capital. Entirely, consistent with the Internal Ratings Based capital charges under Basel II for loan pools held on balance sheet the AFA is arbitrage free in the sense that total capital for all the tranches of a securitisation equals the Basel II IRBA capital for the underlying pool.

The CMA departs from capital neutrality in a simple, transparent way in that it includes, within the notion of capital, tranche Expected Loss (EL). The inclusion of EL implies that capital is monotonic in the seniority of the tranche, a desirable feature in the view of regulators. By restricting non-neutrality to an EL component (rather than introducing non-neutrality, for example, through inconsistent assumptions as was done in BCBS (2012)), the CMA preserves transparency and facilitates sensible, conservative calibration.

⁵ An in-depth analysis of the limits of the modified MSFA employed by the BCBS for the calibration of the SSFA is presented in the document “Calibration of the Simplified Supervisory Formula Approach” (G. Duponchee, W.Perraudin, D. Totouom-Tangho), March 2014.

⁶ For details on the CMA and its calibration, refer to the paper “Calibration of the Conservative Monotone Approach and Regulatory capital for Securitizations”, March 2014.

⁷ Please refer to the website www.riskcontrollimited.com

The CMA calibration approach is based on representative transactions in different regulatory asset classes. Representative asset-class-specific values are employed for PDs, LGDs, maturities and conditional asset correlations, providing an appropriate risk sensitive capital framework applicable by investor as well as originator banks. The CMA calibration approach has the additional important advantage that it consistently deals with IRBA and SA inputs and hence deals appropriately with mixed pools, along the lines also suggested in the following section 7 and actually providing them with theoretical rigour.

3.1. On the calibration of the IRBA approach

In BCBS269 the IRBA approach relies on a SSFA calibration whose main parameters are the IRBA $k(irb)$ and the p value that depends linearly on several deals characteristics.

As already stated, the EBF supports the recalibration of the SSFA (both SA-style and IRBA-style) through the CMA. However, based on the consideration that the p value used by SSFA is supposed to accomplish many roles, including:

- Appropriately determining the allocation of capital across mezzanine and senior tranches
- Determining the level of non-neutrality, i.e., the ratio of capital for all tranches of a securitization transaction to the capital a bank would hold against the underlying pool of assets.

and it fails to adequately accomplish these objectives. The EBF supports the slight modification of the SSFA (Modified SSFA, MSSFA) proposed by the above mentioned academic study. The MSSFA is based on two regulatory parameters, p_1 which is a capital arbitrage-reducing factor for mezzanines, and p_2 which affects the tail of the capital distribution. While the capital surcharge in the SSFA equals p , in the MSSFA it is $(p_2 - p_1)$. The MSSFA calibration is very close to the SSFA calibration while reducing the arbitrage possibilities. For more details, see response to question 2.

In addition to the aforementioned SSFA drawbacks, the operational requirements for IRBA application will limit the possibility for investors to apply it. Consequently, for the rated position held by investors the ERBA will apply, otherwise the SA will apply. It becomes of an utmost importance that ERBA and SA' calibrations allow for a proper differentiation of assets, transactions and underlying risks. We therefore propose to adopt an MSSFA CMA-based calibration also for the SA SSFA.

3.2. On the steepness of the RWA curve in ERBA and the (in)consistency of approaches

As evidenced below the ERBA should also be revised and aligned to the newly recalibrated IRBA and SA.

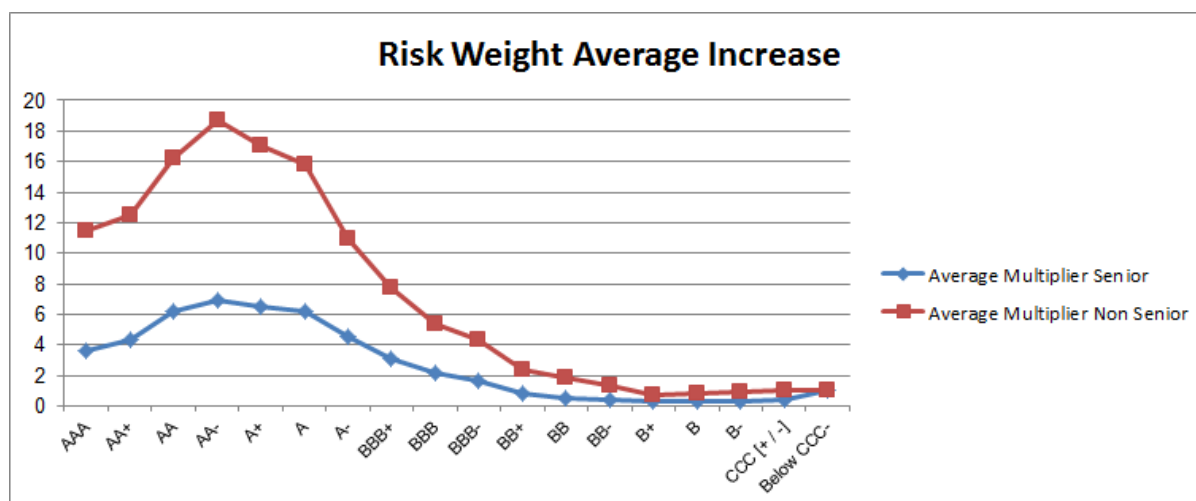
While the Basel Committee's proposed amendment to reduce the RWA floor is welcomed, the EBF considers that the rules could benefit from further consistency of treatment across the

hierarchy of approaches. The nature of the calculation of RWAs under the Standardised Approach has shown itself to be less risk sensitive, in particular for longer dated transactions, which allows transactions for institutions using the Standardised Approach to have greater flexibility of structuring within the RWA floor whereas transactions using the IAA or External Ratings Based Approach are more sensitive to tenor and rating levels. This may have repercussions for the level playing field across jurisdictions and institutions each applying different approaches to the calculation of RWAs for the same asset class/tenor. The Basel Committee notes in BCBS 269 the intention of broadly aligning the calibrations however the significant incremental increases for lower rating attachment points and longer transaction maturities (when applying the ratings table set out in paragraph 60 of the proposed rules) will result in capital calculation divergence across the various approaches being used globally.

The EBF would welcome further clarification on the curve itself and on the incremental increase in capital as the transaction structure has a lower rating. The increase in capital for transactions structured at a lower rating level may result in a similar capital calculation as if lending to the corporate on an unsecured basis. In the case of a sponsor or investor, the current proposals limit the incentive to structure a transaction with additional benefit of security and assets.

Moreover problems still exist also for the better rated structures. Notwithstanding the relatively more sizeable downward revision of RWs for high quality (Investment Grade) senior and non-senior tranches, introduced in this new proposal, does not go far enough to rectify the excessive increase of these RWs introduced with the first consultative document and therefore does not alter our view that high quality tranches would be too much penalised. The revised framework would effectively imply a significant misalignment in the credit risk treatment of securitised exposures with respect to that of the underlying non-securitised assets. For example, using, in a reverse engineering exercise, an approved corporate IRB model for the Kirb calculation to derive the implied average PD consistent with a RW equal to that assigned by the ERB Approach to a 5-year AAA tranche (i.e.25%) would yield a result of 0.13%, which - according to CRA's PD matrix - corresponds to a rating equal to BBB+ for the underlying asset.

For evidence of the pattern of RWs' increases, see also the following graph.



It plots separately, for Senior and Non-Senior tranches, the RWs average increase by rating class under the second consultative paper with respect to the current situation. In particular, the graph makes apparent both a relatively higher RWs' increase for non-senior than for senior tranches of equivalent rating and also a spiking of the RWs' increase in the AA- area (with RWs increasing on average up to 7 times for senior exposures and up to 19 times for non-senior ones).

3.3. On the calibration of the Standardised Approach (SA)

The current calibration of the SA seems to capture hypothetical outlier transactions while it has been designed to be used by a significant number of securitization market 'participants and for a significant number of different assets and transactions. The SA's calibration should be revisited for properly addressing the high quality securitizations or low risk assets.

The EBF supports a more differentiated SA-style MSSFA, using more appropriate p values (p1 and p2) for different fully observable sub-sectors of the securitization market based on regulatory asset classes. For the calibration of the SA-SSFA we propose to use the same approach as for the IRBA, i.e. the MSSFA. This would provide consistency within the regulatory framework and consistent treatment of mixed pools.

Finally, it is worth reminding that the above-mentioned recalibrations should respect the overarching principle that advanced methods should lead to lower risk weights than standardized ones to keep banks' incentives to develop risk-sensitive approaches that are embedded in day-to-day risk management.

4. On the newly proposed hierarchies (flexibility approach)

We welcome the new simplified hierarchy. In particular we appreciate the simplification of the IRB Approach with respect to the MSFA and its apparently less demanding information requirements and that the IAA was kept as an available approach for ABCP transactions. However, there are worries to which extent the IRBA, as the top-of-the-hierarchy-approach with the most attractive calibration (especially once revised), will be applicable for European banks working as sponsors or investors of real economy transactions. For such transactions the proposed calculation of Kirb poses a significant barrier. Although, the proposed top-down-approach is a step in the right direction it still seems unlikely that it will be possible to fulfil its requirements. While real economy originators typically have robust historical data regarding the performance of their receivables there are two main issues: First, these data do not have the level of detail which an advanced IRB bank would hold, hence a calibration fulfilling the full IRBA requirements – as currently proposed – is impossible, in particular for SMEs with their smaller debtor management systems; second for investors such data is completely unavailable, since they have no direct access to the data of the originator and the necessary information would be impossible to be included within the general transaction documentation due to the extensive amount of data currently needed.

Therefore, even though the current proposal states as a principle that banks and their supervisors can be “flexible in the development of IRB estimates”, the issue of data availability - especially for third party originated exposures – is still relevant, also because it is not obvious what type of data (and derived parameter estimates) would be acceptable to regulators in the absence of detailed granular data. As no information provider – and often not even the underlying exposures’ originators – is able to supply such granular detailed data, the lack of a formulation by the Committee of clear operational guidelines on how to calculate Kirb in these circumstances raises significant concerns as to the effective applicability of the IRB Approach. In general, we believe that in these cases the Committee should move in the direction of somehow relaxing the requirements set for the validation of the PD and LGD parameters’ estimation. As an example, the depth of the time series needed for the PD estimation - 5 years - and for the LGD estimation - 7 years - could be shortened.

Moreover, even in the absence of a data availability problem, such as is often the case with exposures to internally structured ABCP programs (based on purchased third party-originated portfolios of receivables) and connected Liquidity Lines (LL) - there is, in our view, the issue of the inappropriate extension of the scope of applicability of a bank’s internal models for the Kirb calculation. Banks’ models are context-dependent, as they are calibrated using historical performance data relating to the bank’s positions in a given product, and a bank’s performance experience might be very different from that of the third party originating the exposures being securitised, thus raising doubts as to the soundness of the application of internally-estimated parameters to third party-originated portfolios.

While for such transactions which are funded through ABCP programmes the IAA is available, all others would have to rely on external ratings or where these are uneconomic on the standardised approach (e.g. due to a small deal size). The effect would be increased funding costs for the real economy going hand in hand with a reduced funding volume which the financial industry would be able to provide. Furthermore the dependence on external rating agencies would increase.

To avoid these surely unintended consequences, we would therefore view the definition by the Committee of a set of minimum requirements for the K_{irb} calculation - addressing both the above-mentioned issues - as highly desirable, not only to facilitate and extend the IRB Approach applicability, but also to address potential concerns on the existence of a level-playing field among institutions in different jurisdictions if these were to implement the Securitisation Framework with different rules. In particular, we propose to allow for a simplified top-down-calculation of K_{irb} based on historical loss rates provided by the originator. For investors being able to apply the IRBA such loss rate data should be included as part of the transaction documentation in a standardised manner.

5. On the usefulness of high-quality labels

The EBF requests more appropriate risk weights for high-quality securitisations which finance the real economy. 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 increasing transparency and reducing 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 and in Germany TSI has developed a similar standard for car loan securitisations. The increased transparency and high quality of the underlying assets warrants a more favourable treatment compared to the currently proposed risk weighting.

The concept of high quality securitisation has been introduced in Europe; it justifies lower solvency ratios for securitisation of granular pools of loans financing the real economy, with controlled origination.

Solvency 2 recognises the following high quality categories:

- (i) Residential mortgages;
- (ii) Loans to SME;
- (iii) Auto-loans;
- (iv) Leasing;
- (v) Consumer finance;
- (vi) Credit card receivables.

In turn, the prime collateralised securitisation (PCS) label recognises these categories:

- (i) Residential Mortgages
- (ii) SME Loans
- (iii) Auto Loans and Leases;
- (iv) Consumer Loans;
- (v) Credit Cards;
- (vi) Dealer Floor-plan Loans;
- (vii) Non-auto Leases;

Assuming that the standardised approach with $p=1$ is calibrated for subprime, then we recommend to implement a modified standardised approach with more appropriate credit surcharge for high quality securitisation. Similarly, the same differentiation in calibration should also be included in the ERBA, IAA and IRBA. CMA-based calibrations could support also this need.

6. On risk weights and floors

We believe that the floor of 15% risk weight means that it is not attractive to securitise pools of very good underlying assets. Thereby the regulation will create adverse selection for the underlings in the securitisation market. As some asset classes tend to have lower risk weights than other asset classes this is likely to also increase correlation in the pools per transaction and in the overall securitisation market. The pro rata caps will only address this issue to a limited extent. Additionally, strong reliance on floors and caps means low risk sensitivity of the framework.

As mentioned, the uncertainty of risk models for the underlying asset pools should be addressed at the level of the asset pools themselves, not at the securitization level and does not justify a floor. We agree that the multi-layering of models which may not be consistent or over simplified may bring uncertainty in the estimate of unexpected losses at the tail of the capital structure (i.e. senior tranches) and thereby may justify a floor.

However, we think that a unique floor of 15% RWA is not appropriate for all securitised assets. For example 15% cannot be appropriate for a hypothetical tranche with high attachment point (such as 80%) and a low risk weight on the underlying pool (for example 20%). In general, a unique 15 % floor introduces a buffer that is too punitive for the senior tranches of the high quality – low risk weight assets, and less so for the other assets.

For entire asset classes, so far there has been no loss on the senior tranches at all, including during the recent crisis (e.g. good quality European RMBS, consumer loans or trade receivables). This is explained by the protection of the senior tranches which has been resilient even in the downturn.

With the recent developments of models such as the CMA, which provides a more comprehensive and consistent approach to capital for securitised portfolios, we believe that the model risk has

been reduced, especially considering the additional layers of conservatism included in these models.

The structures which are the most robust follow a pattern of low risk on the underlying asset (low risk weight), high protection of the senior tranche (high attachment point, distance between attachment point and K_{irb} /KSA), and attachment point higher than LGD.

We therefore propose the Committee to consider a floor structure which better discriminates between low risk and high risk securitised assets:

- For very low risk assets (e.g. senior tranches of low RW RMBS, consumer loans, trade receivables, ...) to be defined as currently discussed by the industry, and when K_{irb} parameters are known (or when applying the approach at the top of the hierarchy), or when ERBA applies, the floor would be 7 %.
- For low risk assets when only KSA is known, the floor would be 10%.
- For all other assets (higher historical default rates such as CMBS, subprime RMBS), the floor would be 15%.

7. On the risk weights of mixed pools

In this second Consultative Document the Committee revises its proposed treatment of “Mixed Pools” by allowing banks to use the Internal Ratings-Based Approach (IRBA), provided they assign a 1250% risk weight to residual exposures in the underlying pool for which K_{irb} cannot be calculated. Alternatively, banks may use the other approaches lower in the hierarchy.

While this constitutes a welcome change - as this type of pool is certainly significant, especially for investing and/or sponsoring banks - the requirement to apply such a high weight to the residual non- K_{irb} exposures seems too punitive. It introduces a total hiatus between positions for which K_{irb} can be computed and those for which it can't and effectively implies that the IRBA would hardly ever be used, as it would penalize even pools with a very high share of IRB assets.

According to our calculations, carried out on a sample set of securitisation tranches differing by seniority, quality and underlying asset class, the break-even point between the relative IRBA-based capital charges (and RW) and the SA-based ones - in terms of percentage of exposures of the underlying portfolio for which K_{irb} cannot be calculated - is generally so low (on average about 5%) that the proposed treatment of mixed pools could greatly reduce the number of cases where the adoption of IRBA is economically convenient, thus counterproductively undermining support for the development of internal risk assessment capacities. In other words, shares of non- K_{irb} positions of the underlying portfolio just slightly higher than the break-even ones presented in the following tables would be sufficient to make the application of the Standardised Approach more appealing than that of the IRBA.

The tables here below report for the various types of tranches:

- The associated risk weights, computed both with the IRBA (assuming the underlying portfolio were entirely an IRB pool) and with the Standardised Approach (assuming the underlying portfolio were entirely a SA pool); as well as
- The break-even share of the non- K_{irb} positions (to be weighed at 1250%) in the underlying portfolio, i.e. the maximum share of non- K_{irb} positions acceptable for the tranche to have an IRBA-determined risk weight not greater than the SA one.

In particular, the first two tables summarize the results respectively for senior tranches (with assumed attachment point = 25%) and junior tranches (with assumed detachment point = 10%) of high quality (AA-AAA) RMBS, CMBS and corporate loans portfolios' securitisations (with K_{irb} values respectively equal to 1.6%, 2.4% and 2.8%).

	RW IRBA (if Floor)	RW IRBA	RW SA (if Floor)	RW SA	%ptf 1250%
RMBS Senior	15,0%	0% (Kirb 1,6%)	15,0%	0,0%	0,0%
CMBS Senior	15,0%	0% (Kirb 2,4%)	15,0%	0,5%	6,9%
Corporate loans Senior	15,0%	0% (Kirb 2,8%)	19,6%	19,6%	14,9%

	RW IRBA (if Floor)	RW IRBA	RW SA (if Floor)	RW SA	%ptf 1250%
RMBS Junior	313,6%	313,6%	704,9%	704,9%	2,1%
CMBS Junior	467,4%	449,5%	922,3%	922,3%	2,8%
Corporate loans Junior	542,6%	521,2%	1232,6%	1232,6%	6,2%

The last table presents results for senior and junior securitisation tranches of worse quality portfolios (with K_{irb} values respectively equal to 5.75%, 6.55% and 6.95% for RMBS, CMBS and corporate loans).

	RW IRBA (if Floor)	RW IRBA	RW SA (if Floor)	RW SA	%ptf 1250%
RMBS Senior	15,0%	0,0%	15,0%	1,4%	5,4%
CMBS Senior	15,0%	0,1%	15,0%	5,4%	8,1%
Corporate loans Senior	15,0%	0,1%	50,4%	50,4%	12,5%
RMBS Junior	1003,8%	1003,8%	1011,5%	1011,5%	0,3%
CMBS Junior	1089,2%	1089,2%	1137,3%	1137,3%	0,8%
Corporate loans Junior	1124,9%	1124,9%	1250,0%	1250,0%	3,2%

A common pattern emerges from the analysis of the various tranches, in that – as one would expect – there generally would be more room for non- K_{irb} positions in the underlying portfolio (i.e. a higher break-even share of position weighed at 1250%) the higher the SA risk weights are with respect to the IRBA-determined ones (even though results are less meaningful for RMBS and CMBS Senior tranches, where the 15% floor would effectively kick-in). In any case, the break-even percentages would be very low in most circumstances.

Given all of the above, we would recommend replacing the 1250% risk weights for the non- K_{irb} positions within the pool with the SA risk weights or the ERBA risk weights to determine their capital charge, which - together with the K_{irb} charge calculated for the IRB assets - would determine the weighted average capital of the underlying portfolio to be fed in the IRBA formula.

For the calibration of the SA-SSFA we propose to use the same approach as for the IRBA SSFA, i.e. the MSSFA calibrated per regulatory asset classes. This would provide consistency within the regulatory framework and consistent treatment of mixed pools. With this approach, there is no need to have a 1250% RW on standardised assets within the mixed pool.

8. On the External Ratings Based Approach and mapping of credit quality steps

Flexibility should be provided to exclude the impact of additional risk factors, if they have been already included in external rating grades.

Under the proposed approach risk weights depend on several risk drivers, in addition to external rating grades provided by ECAIs. Among those drivers BCBS is proposing the tranche maturity and, in the case of non-senior tranches, the tranche thickness.

We agree with the appropriateness of taking into account the relevant risk drivers for securitisation exposures in order to achieve a risk sensitive framework. However, including additional risk factors could give rise to double counting if they are already included in external rating grades.

Methodology implicit in external rating grades provided by ECAIs should not be envisaged as uniform and static. On the contrary, it changes over time and not in the same way for all ECAIs. Hence the importance of supervisor's intervention to approve the ECAIs to be used and to set and update the correspondence (mapping) between the credit quality steps considered in the capital framework with the credit assessment provided by ECAIs.

This correspondence should be based on objective and consistent analysis, as is envisaged in the EU Capital Requirements Directive (CRD IV) and is being proposed for the SA for credit risk by the Joint Committee⁸. Apart from the benefit of ensuring a consistent and harmonised mapping, the analysis behind the mapping of each ECAI and its regular monitoring over time would serve to alleviate any mechanistic overreliance of the credit risk rules on external ratings.

In the case of securitisations, in addition to the strict requirements for ECAIs and their assessments, CRD IV mandates EBA to determine, for all allowed ECAIs, the mapping between credit quality steps and external ratings, based on factors that are objective and consistent. EBA shall consider quantitative factors, such as default and/or loss rates and qualitative factors, such as the methodology used by each ECAI and the meaning of its credit assessment, in order to ensure that securitisation positions to which the same risk is applied on the basis of credit assessment of ECAIs are subject to equivalent degrees of credit risk.

It may be the case that the analysis of the methodology conducted to determine the mapping leads to the conclusion that the tranche maturity is already included in the rating provided by some ECAIs. Then this risk factor should not be counted as an additional risk driver, as it would be the case under the proposal included in the consultative document.

Consequently, we consider that flexibility should be introduced in the External Ratings-Based Approach in order to allow under supervisory assessment that additional risk factors, as tranche maturity, be not considered if they are already included in ratings provided by an ECAI.

9. On maturity adjustments

The definition of maturity remains very conservative. In the current proposal either legal maturity or the weighted average contractual cash flows of the tranche have to be used. However, it is very unusual for a securitisation tranche to have contractually fixed payments (i.e. fixed amounts on fixed dates). Therefore, the second alternative is hardly applicable and almost always the final legal maturity, which is only very vaguely connected to the actual maturity, would have to be used. Given the high impact of maturity in the proposed calibration this approach would lead to a significant overestimation of risk weights for many transactions.

⁸ European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA). Consultative paper JC/CP/2014/01 of 5 February 2014.

Maturity in static pool transactions

While contractually fixed tranche payments are very rare, in static pool transactions the cash flows of the underlying portfolio are often contractually fixed and available during the whole life of the transaction. For such transactions we propose to use the contractual amortisation profile of the pool and transfer this one to one to the tranches of the securitisation (i.e. without any credit to prepayments or other effects). This approach would allow using a definition which is close to the actual maturity while still being conservative and free of model risk.

Furthermore, in the case where the full amortisation profile of the pool is not available a senior cap should be available. It would be similar to the senior cap currently proposed for risk weights, and would limit the maturity of the most senior tranche to the weighted average maturity of the underlying pool. Since the senior tranche amortises faster than the overall pool this is also a conservative approach free of assumptions.

Maturity in replenishing transactions

Similar to static pool transactions the definition of maturity for replenishing transactions seems very conservative. In the current proposal the longest possible maturity of any asset added to the pool during the replenishment phase has to be added to the remaining replenishment period. Understanding the uncertainties in the calculation of maturity in replenishing transactions, at least for senior positions, we propose to take into account contractual safeguards where existing. If for example the weighted average maturity of the replenished pool (without any credit to prepayments or other effects) is contractually limited to a certain value, this term should be used instead of the longest maturity of any single asset. This definition would follow the idea that only contractually documented values can be used, but the resulting value would be much closer to the actual realised maturity. Since the limit is only a maximum value, this definition still would be conservative.

Additionally, the existence of contractual triggers based on the portfolio performance, that would allow originators and/or investors to terminate the replenishment period, should be recognised. Banks (originators or investors) having exposures to this type of transactions should be allowed to treat them in the same way as exposures to static pool transactions (i.e. disregarding altogether the replenishment period) if they have the right to activate such triggers.

Maturity in synthetic transactions

For synthetic transactions, when determining the Maturity Mismatch banks should use the actual values of the pool on a deal by deal basis, if data is available, instead of just taking the longest exposure. This would more adequately reflect the true risk position of the bank.

Take in account prepayment rates in addition to contractual cash-flows of the underlying portfolio

We understand that the Committee wishes to avoid opportunities for regulatory arbitrage or inconsistent treatment that could result from banks using their own assumptions and models to calculate the prepayment rate. Nevertheless, the Committee could adopt a definition of maturity that allows for calculation of maturity using specified, conservative assumptions of prepayment rates according to asset class.

The EBF stands ready to provide a proposal with prepayment assumptions for different asset types.

10. On due diligence requirements

The EBF supports the requirement enacted in the EU from 1 January 2014 by means of articles 406 and 407 of Capital Requirements Regulation (CRR) on progressive RW penalties in case of infringement. Consequently, we request the withdrawal of the proposal in the revised securitisation framework (paragraph 35).

11. On Attachment and detachment points

The Basel framework definition for the credit enhancement (L) is the following: “L is measured (in decimal form) as the ratio of (a) the amount of all securitization exposures subordinate to the tranche in question to (b) the amount of exposures in the pool”.

This definition is unsatisfactory, as the numerator of the ratio is not an assessment of how many assets are available to support the tranche (the traditional meaning of credit enhancement) but an assessment of the subordination of the tranche.

Indeed the large majority of the securitisation market, across jurisdictions, legally do not allocate losses by reverse order of priority (the concept of loss waterfall), but instead allocate only asset proceeds by order of priority (the concept of cash waterfall). The concepts of credit enhancement and subordination are distinct.

As a consequence, we propose the following definition for the Attachment point and Detachment (inspired by the BCBS 269 definition, the US Rule securitization definition and the Nth-to-Default definition): “The values of A and D denote the attachment and detachment points, respectively, for the tranche.

Specifically, A is the attachment point for the tranche that contains the securitization exposure and represents the threshold at which credit losses will first be allocated to the exposure. *This input is the ratio, as expressed as a decimal value ~~between zero and one~~, of the dollar amount of the underlying exposures that provide full credit enhancement to the tranche that contains the*

securitization exposure held by the banking organization to the current dollar amount of all underlying exposures

Parameter D is the detachment point for the tranche that contains the securitisation exposure and represents the threshold at which credit losses allocated to the securitisation exposure would result in a total loss of principal. *This input, which is a decimal value ~~between zero and one~~, equals the value of parameter A plus the ratio of the current dollar amount of the securitization exposures that are pari passu with the banking organization's securitization exposure (that is, have equal seniority with respect to credit risk) to the current dollar amount of all underlying exposures.*

The Attachment point (A) defines the credit enhancement and (D-A) will define the thickness of a tranche.

Adjustment of attachment point for write-downs:

The vast majority of US RMBS tranches are designed with the capacity to extinguish the notes, maintaining a perfect match between the principal of the assets and the principal of the outstanding notes. In essence, the write-downs on the assets side are matched by writing down of the notes within the SPV. The outstanding principal of the assets is then the same as the outstanding principal of the notes. This mechanism to extinguish notes from within the SPV, is equivalent to passing credit-related write-downs (to use US accounting terminology) on a tranche outside the SPV.

However, such a mechanism to extinguish the notes is not part of the European securitisation framework for cash securitisation where the notes will only cease to exist following redemption or at legal final maturity. In Europe, financial institutions will pass credit-related specific provision (to use European accounting terminology) to have the same effect as the credit-related write-downs. Credit-related specific provisions in Europe have the same economic effect as the mechanism to extinguish the notes in US RMBS. But, by not distinguishing the treatment of credit-related provisions from the treatment of discounts in the new Basel proposals (2013c), an asymmetry will be created in the capital framework in favour of US securitisations.

To maintain a level playing field, one must follow the principle of economic substance. When the SPV does not generate a write-down of the tranche, the attachment point A must be adjusted by the specific provision that a bank investor has registered for credit-related issues. In effect, this is equivalent to calculating a pool EAD net of credit-related tranche provisions, and considering that the provision is a junior position within the provisioned tranche. This would replicate the US RMBS write down mechanism.

12. On the application of the IAA

In order to use the IAA, the current proposal⁹ would require a bank to have a certified IRB model for the predominant share of the underlying portfolio.¹⁰ This requirement does not add any value either to the adequacy of IAA ratings or to the simplicity of the framework. On the contrary, it adds cliff effects for transactions with a changing share of SA and IRB assets in the pool, allowing banks to use the IAA in one month and have to rely on the SA in another.

By way of example, consider a transaction financing European consumer debt. While the bank has a certified IRB rating model for its domestic retail customers, this model typically would not be applicable to foreign retail exposures. Hence, the share of domestic loans in the pool would count as IRB assets while all other loans would have to be counted as SA exposures. This means that, for a transaction consisting of, say, 60% domestic and 40% foreign consumer loans, the IAA would be applicable. If those shares were reversed, or if they changed during the life of the transaction, the bank would have to use the SA rather than IAA, leading to completely different risk weights and, in the case of the change during the lifetime, to a sudden jump in the capital requirement. This rule seems very arbitrary and is vulnerable to arbitrage.

The requirement is inappropriate, since the approved IRB model does not play any role when determining capital requirements using the IAA. The IAA is an independent rating model with its own process for approval by supervisors, using inputs which do not change whether a pool is counted as IRB or SA, and which are not connected in any way to a bank's IRB model. Therefore we ask the Committee to remove this requirement by deleting the second and third sentences of paragraph 46.

13. On the treatment of counterparty risk in the calculation of K_{IRB}

No. 50 of the proposed rules text defines counterparty risk to be considered when calculating K_{IRB} . This also includes assets in which the SPV may have invested (e.g. reserve accounts or cash collateral) as well as claims against counterparties resulting from interest rate or currency swaps. We do acknowledge that such assets also contribute to pool RWA and respectively K_{IRB} . However, our analysis showed that the actual impact on K_{IRB} and subsequently the tranche risk weights is only minor, particularly for transactions where minimum requirements on eligible counterparties are imposed. The ongoing inclusion of those positions when calculating K_{IRB} however, would create a considerable effort, in particular when calculating the fluctuating exposure from embedded interest rate or currency swaps. Hence, the proposed rule would impose a significant administrative burden on banks for yielding only a negligible increase in risk sensitivity.

⁹ CD page 9, page 30 proposed rules paragraph 46.

¹⁰ Compare CRR Article 109(1): "Institutions using the Standardised Approach may also use the Internal Assessment Approach where this has been permitted under Article 259(3)"

We therefore propose to define qualitative criteria and additional safeguards, which justify that those assets do not need to be considered when calculating K_{irb} . From our experience appropriate counterparty criteria should be based on initial minimum requirements and a process which takes effect in the case of adverse transition. Initially the following should be fulfilled for a counterparty to be deemed eligible:

- (i) Counterparty fulfils the requirements of an Eligible Guarantor under the relevant jurisdiction¹¹
- (ii) Claims are not subordinated

Safeguards in the case of loss of eligibility could consist of:

- (a) Transfer of cash collateral to eligible deposit bank (reserve accounts, cash collateral)
- (b) Transfer of obligations to eligible counterparty (interest rate or currency swap)
- (c) Counterparty provides collateral to the SPE; deposit bank fulfills (i) and (ii) (interest rate or currency swap)

EBF responses to BCBS 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 welcome the overall approach of the Committee to derivatives other than credit derivatives. Only the requirement to include counterparties related to embedded currency or interest rate hedges in the calculation of K_{irb} should be relaxed if they fulfil certain eligibility criteria (see section 13 of this document). As described above this would create a material burden for banks without yielding significant benefit.

For sake of clarity, we suggest to the committee, in its final paper to describe explicitly the treatment of derivatives (other than credit derivatives) as follows:

$$K_{irb}(\text{swaps}) = \text{Positive swap PV} \times RW_{\text{counterparty}} \times 8\%$$

With :

- $RW_{\text{counterparty}}$ = RW of the swap counterparty according to the IRBA or Standard approach

¹¹ E.g. Art. 247 CRR; §2 US Basel III Final Rule

- Swap PV = value provided by the swap counterparty. If the swap PV is not available, we propose to use a proxy swap PV as follows:

	Proxy PV (SPV perspective)
Float/Float currency swap	Notional x (1- FX current / FX inception)
Fixed/Float, Float/Float	Notional x WAL x (Current Rate - Initial Swap Rate)

The data required to calculate the proxy PV can usually be accessed through different sources available to investors: Offering circular, trustee, widely used valuation models such as Intex. Any cash collateral posted by the swap counterparty to the SPV needs also to be taken into account to reduce the swap PV resulting from the formula.

nb: If the counterparty of the swap is the institution itself, the RW should be null since the institution cannot calculate a capital requirement on itself.

In addition, we suggest to the Committee to consider the case of cash collateral received for positive value of swaps. Indeed, the Current Exposure Method as described in the Basel framework (§186) and that the Basel Committee propose to use for securitisation swaps, allows institutions to deduct the collateral received from the positive value of derivatives.

For swaps that are *pari-passu* with a tranche, since they are rarely rated, we suggest to the Committee to allow institutions to use the rating of the *pari-passu* tranche rather than the subordinated one.

Question 2: *While the formulation of the Internal Ratings-Based Approach is much simpler than the MSFA, the Committee recognizes 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 parameterization of “p”.*

The specification of the “p” parameter, in terms of variables either already affecting the K_{irb} calculation (such as Maturity and LGD) or directly entering the securitisation’s exposures’ capital charge calculation (such as K_{irb} itself) makes the evaluation of the overall impact of those variables on the capital charge itself not immediately obvious, therefore complicating the economic interpretation and raising concerns of double-counting.

The maturity of the tranche M_t should be removed as a parameter in the proposed IRBA SSFA and instead one should use the maturity concept in the calibration of capital surcharge and correlation per regulatory asset classes.

Similarly the granularity parameter N should be removed as a parameter and only be used as a parameter for non-granular pools.

Both maturity and granularity concepts could be taken into account as part of a calibration per regulatory asset classes.

The pool parameters for granular pools would then be only K(IRBA) and LGD in an SSFA using only one p.

We would therefore favour linking the calibration of “p” to a proper economic model such as the CMA (currently proposed by the AFA Group).

The enclosed document “Calibration of the Simplified Supervisory Formula Approach” elaborated by several members and supported by the EBF lays out a proposal for a more straightforward and transparent calibration.

We would support for the MSSFA (SSFA with two p values) and the following inputs:

	Securitisation Regulatory Asset Class	Senior			Non-Senior		
		p_2	p_1	(p_2-p_1)	p_2	p_1	(p_2-p_1)
Wholesale	Granular Short Term Bank/Corporate	0.34	0.28	7%	0.37	0.26	11%
	Granular Low RW Medium to Long Term Bank/Corporate	0.77	0.64	13%	0.85	0.58	26%
	Granular High RW Medium to Long Term Bank/Corporate	0.47	0.31	17%	0.63	0.22	41%
	Granular Small- and Medium-sized Entities	0.65	0.54	12%	0.73	0.49	25%
	Specialised Lending (Commodities Finance)	0.25	0.19	6%	0.32	0.14	18%
	Specialised Lending (Project Finance)	0.98	0.78	20%	1.16	0.69	47%
	Specialised Lending (Object Finance)	0.73	0.47	26%	1.03	0.35	69%
	Specialised Lending (Income Producing Real Estate)	1.06	0.93	13%	1.16	0.87	29%
	Specialised Lending (High Volatility Commercial Real Estate)	0.90	0.72	18%	1.03	0.65	37%
	Other Granular Wholesale	1.01	0.88	13%	1.12	0.81	31%
	Other Non-Granular Wholesale	1.17	1.00	17%	1.34	1.00	34%
Retail	Low RW Residential Mortgages	0.62	0.42	21%	0.86	0.31	55%
	High RW Residential Mortgages	0.56	0.29	28%	1.03	0.16	88%
	Revolving Qualifying Retail	0.27	0.18	9%	0.44	0.09	35%
	Other Retail	0.73	0.57	16%	0.90	0.48	42%

In order to complete the remarks already formulated above on p parameter, we suggest for limit the maximum capital surcharge and reduce the minimum capital surcharge.

For the IRBA and SA, based on the results of the MSSFA recalibration with the CMA, we support the following caps and floors for the capital surcharge:

- a cap on the capital surcharge ($p_2 - p_1$) of a maximum 0.3 for senior positions and 0.9 for non-senior positions
- a floor for the capital surcharge ($p_2 - p_1$) of 0.06 for senior positions and 0.11 for non-senior positions,

Question 3: *If respondents favored 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 understand that the addition of the overall cap aims to provide with more sensible capital requirements for an originator bank, which should not be required to hold more capital after securitisation than before.

The proposal of the Committee of a pro rata calculation of the maximum capital requirement, where a bank determines its maximum capital requirement by multiplying the largest proportion of interest that the bank holds for each tranche by the capital charge of the underlying pool is in our view a positive achievement compared to the BCBS 236 proposal where the cap was simply on the total capital charge of the underlying portfolio.

However, we believe that the idea of capital neutrality for originators, which underlies this proposal, is only partially transcribed by this computation, especially when an originator bank achieves significant risk transfer and net economic interest retention in the transaction at the same time.

We believe that in order to avoid any regulatory arbitrage and to provide with more conservative capital charge for an originator bank the overall cap should be computed by multiplying the percentage of economic interest held by the originator bank by the capital charge of the underlying pool.

CRR Net economic interest retention rules (Art. 405) claims for an overall cap proportional to the underlying portfolio capital charge for originators:

An originator willing to attract investors regulated by CRR has to retain at least 5% of net economic interest in the securitisation. Under CRR Art. 405, this can be achieved through vertical retention of 5% of each tranches or through random selection of 5% of the assets to be transferred to the SPV.

If the option of random selection is chosen, the capital charge for the originator after securitisation would equal 5% of the portfolio before securitisation (assuming a granular pool), whereas the capital charge after securitisation would be greater with the vertical retention option.

For instance, let us assume a French RMBS structure aiming risk transfer. The risk parameters of the underlying pool are estimated under the IRB approach and are reflective from the average good quality of the French residential book:

N parameter	10,000
EAD	1,000 M€
WA 1 year PD	1.5%
WA LGD	15.0%
EL	2.3 M€
RWA	100.0 M€
Kirb	10.3 M€

For the purpose of the example, we assume a tranching similar to the one achieved by Orange Lion 2013-10, which is a €2bn Dutch prime RMBS transaction issued in July 2013, where the originator has achieved sale of all credit risk in the underlying portfolio to external investors.

The IRB approach would be applied for the capital charge computation of the securitised exposures (retail parameters). If we assume a vertical 5% retention of all the tranches:

Class	Attachment point	Detachment point	Maturity (Y)	% Retention	p	KSSFA	Tranche RW (%)	Tranche RWA (total)	Tranche RWA (Originator)	Capital charge for Originator
A	9.1%	100.0%	5	5%	123%	0.0%	15.0%	136 M€	7 M€	0.5 M€
B	6.4%	9.1%	5	5%	137%	1.0%	15.0%	4 M€	0 M€	0.0 M€
C	4.1%	6.4%	5	5%	137%	5.6%	70.1%	16 M€	1 M€	0.1 M€
D	2.2%	4.1%	5	5%	137%	24.3%	303.9%	59 M€	3 M€	0.2 M€
E	0.5%	2.2%	5	5%	137%	68.8%	984.1%	162 M€	8 M€	0.6 M€
F	0.0%	0.5%	5	5%	137%	121.1%	1250.0%	63 M€	3 M€	0.3 M€
								441 M€	22 M€	1.8 M€

Under such an example and without the overall cap, the originator would have a capital charge of 1.8 M€ after securitisation, equal to 5% of the total capital charge of the tranches, which should reflect 5% of the risks of the underlying portfolio, whereas the 5% share of the portfolio risks would actually equal 0.5 M€ if it was directly computed on the capital charge of the underlying portfolio (5%*10.3 M€).

Despite the transfer of 95% of the net economic interest to external investors, the originator would proportionally have more capital charge after securitisation than before if no overall cap based on the underlying portfolio's capital was applied.

This example claims for an overall cap based on the capital charge of the underlying pool since it would create a discrepancy between the two options permitted by the CRR regulation to achieve the net economic interest retention.

This first example leads also to the fact that the overall cap for an originator should be computed as the multiplication of the capital charge of the underlying pool by the economic interest retention proportion instead of the maximum proportion of retention of all the tranches.

Indeed, the proposed overall cap could create an incentive for originator to transfer the riskiest tranches of the structure. For instance, let us consider the same structure as in the first example, but where 20% retention is achieved on the mezzanine tranches C and D:

Retention structure n°1 :

Class	Attachment point	Detachment point	Maturity (Y)	% Retention	p	KSSFA	Tranche RW	Tranche RWA (total)	Tranche RWA (Originator)	Capital charge for Originator
A	9.1%	100.0%	5	5%	123%	0.0%	15.0%	136 M€	7 M€	0.5 M€
B	6.4%	9.1%	5	5%	137%	1.0%	15.0%	4 M€	0 M€	0.0 M€
C	4.1%	6.4%	5	20%	137%	5.6%	70.1%	16 M€	3 M€	0.3 M€
D	2.2%	4.1%	5	20%	137%	24.3%	303.9%	59 M€	12 M€	0.9 M€
E	0.5%	2.2%	5	5%	137%	68.8%	984.1%	162 M€	8 M€	0.6 M€
F	0.0%	0.5%	5	5%	137%	121.1%	1250.0%	63 M€	3 M€	0.3 M€
								441 M€	33 M€	2.7 M€

The overall cap computed as the maximum retention of each tranches multiplied by the underlying pool capital would equal 2.05 M€ (20%*10.3 M€). This overall cap would be exactly the same if the 20% retention was on the most junior tranches E and F as follow:

Retention structure n°2:

Class	Attachment point	Detachment point	Maturity (Y)	% Retention	p	KSSFA	Tranche RW	Tranche RWA (total)	Tranche RWA (Originator)	Capital charge for Originator
A	9.1%	100.0%	5	5%	123%	0.0%	15.0%	136 M€	7 M€	0.5 M€
B	6.4%	9.1%	5	5%	137%	1.0%	15.0%	4 M€	0 M€	0.0 M€
C	4.1%	6.4%	5	5%	137%	5.6%	70.1%	16 M€	1 M€	0.1 M€
D	2.2%	4.1%	5	5%	137%	24.3%	303.9%	59 M€	3 M€	0.2 M€
E	0.5%	2.2%	5	20%	137%	68.8%	984.1%	162 M€	32 M€	2.6 M€
F	0.0%	0.5%	5	20%	137%	121.1%	1250.0%	63 M€	13 M€	1.0 M€
								441 M€	56 M€	4.5 M€

In order to avoid any regulatory incentive, we believe that the overall cap should be computed as the capital charge of the underlying pool (10.3 M€) multiplied by the percentage of economic interest retained by the originator after securitisation. This percentage of economic retention should be seen as the RWA after securitisation retained by the originator divided by the total RWA after securitisation.

With the overall cap computation proposed by the Committee, the retention structure n°1 and n°2 would be exactly the same from an originator capital charge point of view: the overall cap would equal 2.05 M€, whereas the retention of risk is not the same. Our proposal to compute the cap on the % of economic retention would lead in our view to more conservative capital charge for the originator and to a more continuous overall cap:

	Retention structure n°1	Retention structure n°2
Kirb (A)	10.3 M€	10.3 M€
RWA retained by originator after securitisation (B)	33.3 M€	56 M€
Total RWA after securitisation (C)	440.5 M€	440.5 M€
% of originator economic interest (D = B/C)	7.56%	12.66%
Overall Cap (A * D)	0.8 M€	1.3 M€