German Banking Industry Committee

Die Deutsche Kreditwirtschaft

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21 March 2014

Consultative Document
Revisions to the securitisation framework (BCBS 269)

Dear Sir or Madam,

please find enclosed the comments of the German Banking Industry Committee on your Consultative Document concerning Revisions to the securitisation framework.

The German Banking Industry Committee is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,200 banks.

We kindly would like to inform you of our position on those aspects which from our point of view are most relevant to the German Banking Industry.

If you have any questions, please do not hesitate to contact Anna Niemitz.

Yours sincerely
on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks

by proxy

Dr. Andreas Martin

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Comments

on the Basel Committee's consultative document "Revisions to the securitisation framework" (BCBS 269)

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Berlin, 14-03-21

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Opinion on the Basel Committee's consultative document "Revisions to the securitisation framework" (BCBS 269) dated 21 March 2014

I. General comments

We welcome the Basel Committee's making available for discussion a revised version of the consultative document for future capital adequacy requirements with regard to securitisation positions. Compared with the first document a number of improvements have been made. We welcome in particular that the complexity of the hierarchy of approaches has been reduced. This includes the application of the ERBA (External Ratings-Based Approach)even if the securitisation position being considered has been externally rated by only one agency as well as the retention of the Internal Assessment Approach (IAA).

We welcome also that the excessive capital adequacy requirements of the first consultative document have been reduced. However, to us the proposed calibration still seems to be too high overall. This applies particularly when the capital adequacy requirements are compared with those for the securitised portfolio or similarly rated comparable products (e.g. covered bonds/debentures).

Nonetheless, we believe that overall the proposed framework will lead to a number of negative consequences:

- Volume of credit available for the economy and supplied by the banking system will decrease
- Collateralsied Funding will be substituted by uncollateralised funding and thus the risk in the financial system will rise
- Financing costs for the real economy would rise

Different calibration for high quality assets

We are concerned that some of the conservatism in the proposed calibration stems from the need for having to find a calibration which works for all kinds of securitisations, without being able to take certain qualitative characteristics into account. For example, in a Technical Report on Long-term Investment (Technical Report on Standard Formula Design and Calibration for Certain Long-Term Investments, EIOPA, 19/13/2013), the European Insurance and Occupational Pensions Authority (EIOPA) proposed a definition of high quality securitisations (so-called 'Type A' securitisations) which profit from lower capital requirements. We propose using a similar definition in the context of the Basel Framework for Securitisations. Possible starting points for taking into account such a differentiation in the calibration would, for example, be an adjustment of the floor and the factor "p".

Enhancing the use of the IAA

We agree with the Basel Committee that those approaches should top the hierarchy that are based on banks' internal procedures for evaluating securitised portfolios. The Internal Assessment Approach (IAA) is a familiar and proven process that has been approved by the supervisors/regulators. The present formulation of the consultation document, however, leaves open to a certain degree under which conditions the IAA may be applied. A minimum condition for using the IAA is the basic ability to use the IRB approach (for a predominant share of the type of underlying pool exposures). At the same time the IRBA must be used if the bank has both the approval and sufficient information to calculate K_{IRB} for the pool. The possibility of using the IAA should not be unnecessarily restricted by the relative "vicinity" of the minimum condition for applying the IAA and the adequate criterion for the compulsory use of the IRBA. As long as a bank can demonstrate to its supervisory authority that the IAA is more suitable than

the IRBA then the use of the IAA should be possible. We suggest that this should be taken on board as an explicit rule. Furthermore, the IAA should be applicable regardless of the classification of the underlying portfolio as IRBA.

Our proposed treatment of the IAA is in our opinion justified, since banks that apply the IAA have better risk assessment procedures than external rating agencies. The IAA facilitates the aim of independence from external ratings and is at the same time subject to supervisory control. The risk inherent in a securitisation is independent of whether the position is shown in the balance sheet or held in a conduit and supported by means of a liquidity facility. For this reason, it also seems appropriate to us to extend the scope of application of the IAA, which until now included only positions in ABCP programmes, to further securitisation positions (especially to transactions relating to the real economy).

Floor

While we welcome the lowering of the floor from 20% to 15% we still believe that by doubling the risk weights compared with those of the existing regime, this floor does not adequately address the risks of ABS in the most liquid and resilient sectors such as Dutch RMBS or Auto ABS. We believe that the Basel Committee's conclusion that "capital requirements for highly rated securitisation exposures proved to be too low, in the light of the performance during the crisis" a) does not take into account the performance of e.g. the above ABS assets during the crisis and thereby treats "good" and "bad" highly rated ABS (unjustifiably) equally; and b) ignores the actual multiple risk drivers for the performance (including potentially wrong assessment) that should form the basis of the risk weights – i.e. relating performance and risk weight without taking into account the reasons for the performance is too simplistic and leads to the concerns expressed under a).

Besides, in many cases it is impossible to reach the floor. For long-term tranches the floor is 25%. This is problematic, particularly as the definition of maturity often exceeds the effective tenor and so the longest tenor must be assumed (cf. our remarks on maturity). This effective multiplication by a factor >3 compared to the current framework could, moreover, bring about an adverse selection for the make-up of the underlying pool.

Exemption of existing transactions

The new regulations should not be applied until after an appropriate transition phase. From what we understand, this is not supposed to be completed until the end of 2017. Despite this, we would like to advocate that securitisation transactions that already existed at the time of adopting the new regulations be exempted from these regulations. The pricing of securitisations in the market was made in the expectation that the existing regulations would remain unchanged for the entire duration of the transaction. An increase in capital adequacy requirements for existing securitisation positions would thus mean that numerous transactions would in retrospect turn out to be uneconomical. Because confidence has not yet been restored to the securitisation markets, the banks could react to this only to a limited extent by selling these positions. The only possibility would probably be to sell these positions at deep discounts to currently still unregulated shadow banks (particularly hedge funds).

Opinion on the Basel Committee's consultative document "Revisions to the securitisation framework" (BCBS 269) dated 21 March 2014

Use of the ERBA

With the current regulations we see a potential problem of implicit pressure arising to use the IRBA, even for institutions for which the application of the IRBA would be very time-consuming and costly. This possible pressure from supervisory authorities and the market right up to a de facto necessity to use the IRBA would apply to investors too. So as not to jeopardise a recovery of the securitisation market it should not come to the point that certain investors are forced to withdraw from the market because the expense for the use of the IRBA does not pay off. We therefore regard express permission to use the ERBA also for IRB-Institutions in future - with securitisation portfolios comparatively small in relation to an institution's size - as opportune and suggest such an exemption.

II. Specific comments

These specific comments refer to the numbered points/paragraphs in the regulatory text.

Paragraph 7 - Definition of the Originator

The current definition of the originator in paragraph 543 (b) of the current Basel securitisation framework of June 2006 is unchanged in the proposals. It reads:

> *"For risk-based capital purposes, a bank is considered to be an originator with regard to a certain securitisation if it meets either of the following conditions:*
> *(a) […]*
> *(b) The bank serves as a sponsor of an asset-backed commercial paper (ABCP) conduit or similar programme that acquires exposures from third-party entities. In the context of such programmes, a bank would generally be considered a sponsor and, in turn, an originator if it, in fact or in substance, manages or advises the programme, places securities into the market, or provides liquidity and/or credit enhancements.*

From our point of view the Basel securitisation framework does not differentiate between originator and sponsor. European legislation therefore made a different definition of originator and sponsor (Art. 4 (13) and (14) CRR) which in our view is more appropriate. Taking the current BCBS definition, from a European point of view, all sponsors are treated as originators and, as the case may be, be burdened with corresponding obligations.

Therefore, we ask the Basel Committee to review the definition and take a closer look at the European definitions.

Paragraph 14 - Implicit support

The current definition in paragraph 551 of the current Basel Securitisation Framework of June 2006 is unchanged in the proposals. It reads:

> *"Implicit support arises when a bank provides support to a securitisation in excess of its predetermined contractual obligation."*

This definition does not correspond with the European legal concept of non-contractual credit support in Art. 248 CRR. The purpose of this European norm: sponsors or originators which, in recognising mitigation when calculating risk exposure eligibility in respect of receivables transferred, retroactively reassume the risks through the assumption beyond contractual obligations of investors' losses in the respective transactions. It allows a differentiation of support according to arm's length criteria, so that implicit support is given only when support beyond contractual obligations is not provided at arm's length.

In contrast, paragraph 551 defines only the term implicit support dependent on the contractual obligations of the sponsor/originator.

This definition has long been superseded by European law. Should the term in paragraph 14 possibly be included in a European regulation, ABCP sponsors/originators, for example, which, for example, buy beyond contractual obligations - but at arm's length - own CP for market making would constitute implicit support.

Paragraph 15 - Prohibition of the use of IRBA

National supervisors should be allowed to prohibit the application of the IRBA, if it did not generate adequate capital adequacy requirements because of the structure of the securitisation. In our view this is problematic, particularly as the criteria ("highly complex loss allocation", "high internal correlations") to be applied in this respect are worded very vaguely. In any case, that the application of the IRBA for each transaction has to be coordinated with the supervisor should be avoided.

Paragraphs 22, 23 - Tranche Maturity

The parameter M_T is defined as "Euro weighted-average of the maturity of the contractual cash flows of the tranche". The term "contractual cash flows" here is not clear. This applies with regard to paragraph 23 too, which focuses on the cash flows "contractually payable by the borrower". We assume that "cash flows of the tranche" mean the cash flows that result from the application of the waterfall on the contractual cash flows from the underlying assets, whereby neither the expected prepayments nor the expected losses are incorporated in the calculation.

In any other case, 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 connected only very vaguely 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.

<u>Maturity in static pool transactions</u>
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 maturity 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, 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 at least for the senior tranche 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.

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.

Paragraphs 40, 41 in conjunction with paragraphs 63g, 64 and 65 as well as 66 and 67a - risk weights with "overlapping exposures" between liquidity facility and ABCP

Paragraph 40 should govern the situation where given overlapping exposures the overlapping part must be taken into account only once, whereby the higher risk weight of the overlapping positions counts. In paragraph 41 examples are given for the calculation of the overlap of ABCP and liquidity facility. How the risk weights of the ABCP are to be calculated, however, is not regulated here.

Insofar as a bank cannot not use the IRBA in the calculation of the risk weight of the ABCP held by it, paragraph 63g prohibits the use of the external credit assessment in a large number of applications. Because ABCP and liquidity facility are as a rule of equal ranking, inferred ratings are not provided for in paragraphs 64 and 65, just as the application of the IAA for assessing ABCP is not allowed under paragraphs 66 and 67a either.

In our opinion, it is appropriate in this situation to use the risk weight of the liquidity facility (average risk weight where several transaction-specific liquidity facilities are posted) for the ABCP analogous to the European ruling in Art. 248 (3) CRR.

Paragraph 46 - Hierarchy of approaches for SA pools

The following wording in paragraph 46 is unclear:

> *"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."*

We request clarification that this means merely that bank means an IRBA institution. However, in our opinion, it should **not** be necessary that the bank have approval for the "IRB approach" for securitised receivables.

It is not evident what benefit is derived from the availability of an approved rating system for the IRB for the greater part of the securitised classes of receivables when applying the IAA, but that is not even used for capital adequacy calculations. For these reasons this requirement was removed from the European rules pursuant to Art. 109 CRR. We propose to follow this reasoning and not to take a step back.

Paragraph 48 - Application of the IRBA to mixed portfolios

We welcome that the new proposal allows transactions to use the IRBA for mixed pools of IRBA and SA assets. However, the need to apply the risk weight of 1250% to the SA assets adds a stringent degree of conservatism even for transactions which consist almost solely of IRBA assets. To avoid this, we propose the use of the risk weights from the general Standardised Approach for these assets up to a threshold of 10%. This is a typical value for the share of SA assets in mixed pools. Hence, with this threshold the IRBA could produce meaningful results for many transactions.

For SA assets which surpass this threshold we propose to apply the most conservative risk weight possible under the SA wholesale framework i.e. 150%. The proposed value of 1250% commensurates with the treament of securitisations under the SA. However, since transactions containing securitisation in the underlying pool are excluded from the use of the IRBA anyway (i.e. resecuritisations), there is no necessity to apply this risk weight.

Paragraph 50 and page 7 – The treatment of counterparty risk in the calculation of K_{IRB}

As we understand it, calculating the risk weight of a swap and the K_{IRB} factor gives rise to circular reasoning, since the risk weight of the swap is needed for the calculation of the K_{IRB} factor to determine the denominator, but conversely the K_{IRB} of a transaction must be known to be able to derive the risk weight of a swap. The same is true for assets in which the securitisation special purpose entity (SPE) may have invested (e.g. reserve accounts or cash collateral).

We acknowledge that such swaps and assets also contribute to pool the 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 require 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.

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 framework as implemented in the relevant jurisdiction.
(ii) Claims are not subordinated.

Safeguards in the case of loss of eligibility could be the following:

(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 fulfils (i) and (ii) (interest rate or currency swap)

Paragraph 54 Calibration of the supervisory parameter „p"

The calibration of the supervisory parameter "p" appears in terms of the parameters „D" and „E" not appropriate for the securitised retail portfolio. The parameter "D" is part of the product with the parameter LGD and the parameter „E" is part of the product with the parameter maturity Mt. Especially, the calibration of the parameter „E" for the securitised retail portfolio is in all combinations three times higher than in the securitised wholesale portfolio. This appears not appropriate. Moreover, it is not fully clear what exactly "wholesale" means. If the securitised corporate portfolio is meant then this term should be used for the sake of clarity and consistency.

Intuitively not comprehensible is, that the parameter „D", that is to be multiplied with the parameter LGD, is so high for high granular retail ABS tranches irrespective of the seniority. On the other hand, the parameter "D" is less than the half for non-senior granular wholesale tranches compared to retail tranches.

Altogether, we recommend to review the calibration based on the loan level data of the QIS II in terms of risk sensitivity and to revise accordingly.

Paragraph 54 (ii) LGD for dilution risks

In calculating the receivables-weighted LGD an LGD of 100% is stipulated for use in dilution risks. This appears to us to be excessively conservative. Instead, we advocate that such positions according to the IRBA provisions for dilution risk of purchased receivables have an LGD weighting of 75%.

In addition, it should be ensured that for standard-approach positions no LGD has to be calculated.

Paragraph 60 - Risk weights in ERBA

In our view, the risk weights in ERBA are clearly still too high.

Here too, the level of the proposed risk weights for all asset classes continues to be at least twice as high, for long-term AAA tranches even more than three times as high than before. In comparing the asset classes in ABS business and in comparison with other financial instruments without securitised exposures the calibration for securitised assets is way too high. The risk weights are thus higher than, for example, those for comparably rated unsecured corporate bonds. They too are significantly over those for covered bonds and in part even over the weights of non-securitised pools of receivables (e.g. an "A+" junior tranche of a car-loan securitisation would have a risk weight of 170%).

<u>High Quality ABS</u>
An analysis of the empirically observed impairment rates - rating migrations to CC and worse - on the basis of the observed average annual impairment rates up until 2011 published by the agencies Moody's, Fitch and S&P bears out that one would have to differentiate between different asset classes:

	Observed impairment rates according to asset class and region				
	ABS	US RMBS	Rest RMBS	CMBS & CLOs	CDOs ohne CLOs
AAA	0,01%	0,94%	0,11%	0,04%	2,84%
AA	0,04%	4,57%	0,33%	0,14%	4,33%
A	0,17%	7,29%	0,24%	0,20%	6,58%
BBB	0,48%	13,02%	0,55%	0,78%	10,19%
BB	2,92%	24,35%	5,43%	2,54%	15,49%
B	13,26%	35,73%	23,58%	6,47%	26,44%
CCC	34,15%	61,02%	22,67%	33,31%	43,86%

The analysis illustrates that particularly for the asset classes US RMBS and CDO without CLO for the well rated securities significantly higher impairment rates are observed than in the other asset classes.

On the other side of the spectrum European Auto-ABS e.g. showed - based on an analysis of Fitch Ratings Global Structures Finance, which set out the rating migrations to CC or worse between 1996 and 2012 - the lowest impairment rates.

Impairement Rates for Auto-ABS - Fitch Rating (1996 - 2012)	
AAA	0,00%
AA	0,00%
A	0,00%
BBB	0,53%
BB	0,93%
B	8,00%
CCC	33,33%

We therefore deem it important to differentiate the risk weights between high quality and other securitizations.

Implicit floor

We criticize the factual 25% risk-weight floor under the External Ratings-Based Approach (ERBA) even for an AAA-rated senior exposure with a 5-year maturity. As most tranche maturities are closer to 4 or 5 years (particularly given the proposed definition of Tranche Maturity) than 1 year, the "effective" risk-weight floor under ERBA is much closer to 25% than 15%. Hence, the true or "effective" floor for banks that apply ERBA will be more than triple the 7% risk-weight floor under the current framework. We believe that the tripling of the floor is overly punitive and punishes long term financing of the real economy. Even if the Committee maintains its position, high quality ABS should be allowed to reach the floor of 15 %.

Paragraph 64 in conjunction with 66

Interest rate hedging in ABCP programmes often uses swaps that are of senior to, or the same rank as, a liquidity facility that can be assessed by means of the IAA. It should be clarified that for such swaps it is possible to derive a rating analogous to that in paragraphparagraphs 64/65. When the external taring of the ABCP cannot be used because of paragraph 63 lit. g, it should be allowed to transfer the risk weight of the liquidity facilities (average risk weight where several transaction-specific liquidity facilities are posted) to the swaps.

Paragraph 76 Level of the supervisory parameter "p" in the Standardised Approach

We welcome the reduction of the supervisory parameter "p" to 1. Nevertheless, we are of the opinion that it should be reduced further to a value of 0.5 percent, as it is currently applied in the USA. Furthermore, "p" should be different for high quality and other securitizations.

Paragraph 83 - Treatment of resecuritisation positions

A basically very conservative approach with resecuritisations is understandable. However, here too there are different construction qualities, all of which fall under the definition of resecuritisation. As soon as the underlying pool of tranches has even only one single securitisation the more stringent rules for resecuritisation are supposed to be applied. For many "resecuritisations" this seems to us to be too conservative.

We therefore do not agree with the restriction for resecuritisation to the "Standardised Approach" (SA). One would thus have to fall back on external ratings. To achieve the goal of reducing the significance of external ratings, however, we would propose similar treatment to that of the "mixed pools". One uses the IRBA for resecuritisations and implements the following modification:

- K_{IRB} is calculated on the basis of the underlying assets and if this involves a securitisation the rules of the Securitisation Framework are applied; or
- K_{IRB} is calculated on the basis of the underlying assets and a risk weight of 1250% is used for the resecuritisation in the pool (for the remaining underlying assets the normal IRB rules apply).

Furthermore, p should not be applied to the whole transaction, but only pro rata to the portion of the pool which constitutes a resecuritisation. The application of p to the whole transaction would be a considerable overstatement of the risk.

Question 1
We welcome the overall approach of the committee to derivatives other than credit derivates. 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 comment to paragraph 50 of this document). As described this would create a material burden for banks without yielding significant benefit.

Question 2
We do not consider further simplification of the factor p to be appropriate. In fact, the quality of the securitisation of the transaction should be an additional parameter for p (see also our general comments).

Question 3
We favour the introduction of an overall pro rata cap. We consider the arrangement in CP by no means too conservative.

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